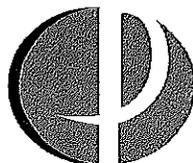


***Employee's Retirement System of the
Government of the Commonwealth
of Puerto Rico
(A Pension Trust Fund of the Commonwealth of
Puerto Rico)***

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



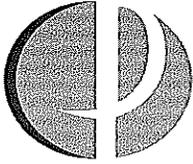
PARISSI P.S.C.
Certified Public Accountants, Tax & Business Advisors

***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, 2007 and 2006
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, 2007 and 2006 and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material 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.

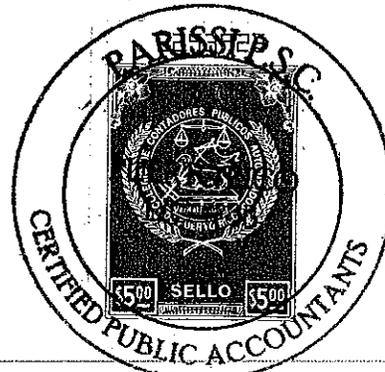
In our opinion the financial statements referred to above present fairly, in all material respects, the net assets of the System as of June 30, 2007 and 2006, and the changes in its net assets for the years then ended in conformity with accounting principles generally accepted in the United States of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

The management's discussion and analysis on pages 2 through 10 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of 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.

Our audits were conducted for the purpose of forming opinions on the financial statements of the System. The schedule of employers' contributions and funding progress for the year ended June 30, 2007 included on pages 38 through 40 are presented for purposes of additional analysis and is not a required part of the basic financial statements. These schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

San Juan, Puerto Rico
December 28, 2007

Stamp No. 2293925 was affixed
to the original of this report.
License No. 88 Exp. December 1, 2008



***Employee's Retirement System of the Government
of the Commonwealth of Puerto Rico
(A Pension Trust Fund of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis
Years Ended June 30, 2007 and 2006***

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 mortgages 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, 2007 and 2006. 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 basic 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. Overtime, 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 \$2,931 and \$2,776 million in total assets as of June 30, 2007 and 2006, respectively. This amount consists of the following:

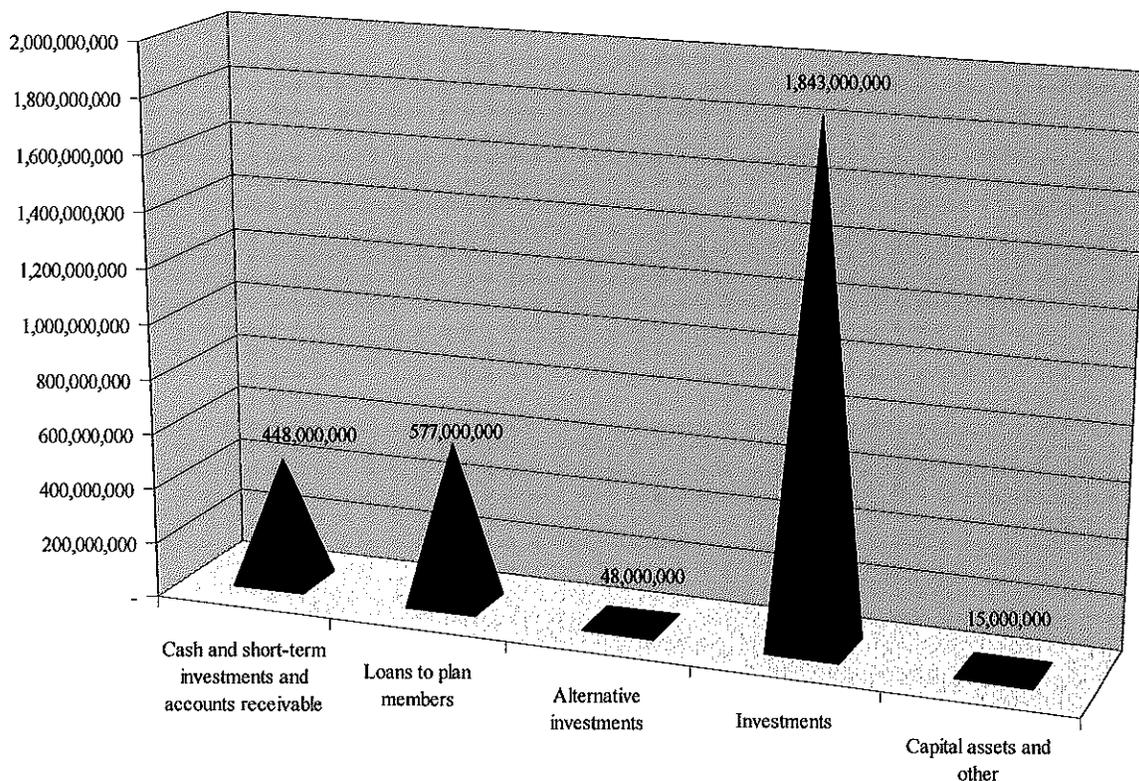
Employee's Retirement System of the Government of the Commonwealth of Puerto Rico

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Management's Discussion and Analysis

Years Ended June 30, 2007 and 2006

- \$448 million in cash and short-term investments and accounts receivable
- \$577 million in loans to plan members
- \$48 million in alternative investments
- \$1,843 million in investments
- \$15 million in capital assets and other



For fiscal year ended June 30, 2006, consists of the following:

- \$164 million in cash and short-term investments and accounts receivable
- \$529 million in loans to plan members
- \$42 million in alternative investments
- \$1,531 million in investments
- \$495 million in the investment in PRTA Holdings Preferred Stock
- \$15 million in capital assets and other

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Years Ended June 30, 2007 and 2006

The following provides a comparison of certain items within the financial statements:

	2007	2006	Total Dollar Change	Total Percentage Change
Assets (in thousands)				
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	<u>2,931,300</u>	<u>2,776,142</u>	<u>155,158</u>	<u>5.6%</u>
Liabilities				
Accounts payable and accrued liabilities	10,125	9,246	879	9.5%
Insurance reserve for loans to plan members and investment settlements	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	<u>39,799</u>	<u>234,811</u>	<u>(195,012)</u>	<u>-83.1%</u>
Total net assets held in trust for pension benefits	<u>\$ 2,891,501</u>	<u>2,541,331</u>	<u>350,170</u>	<u>13.8%</u>

	2006	2005	Total Dollar Change	Total Percentage Change
Assets (in thousands)				
Cash and short-term investments and total accounts receivable	\$ 163,651	127,640	36,011	28.2%
Investments	2,068,653	1,893,896	174,757	9.2%
Loans to plan members	528,552	465,247	63,305	13.6%
Capital assets and other	15,286	16,175	(889)	-5.5%
Total assets	<u>2,776,142</u>	<u>2,502,958</u>	<u>273,184</u>	<u>10.9%</u>
Liabilities				
Accounts payable and accrued liabilities	9,246	9,648	(402)	-4.2%
Insurance reserve for loans to plan members and investment settlements	148,686	160,445	(11,759)	-7.3%
Line of credit	60,000	—	60,000	100.0%
Other liabilities	16,879	4,994	11,885	238.0%
Total liabilities	<u>234,811</u>	<u>175,087</u>	<u>59,724</u>	<u>34.1%</u>
Total net assets held in trust for pension benefits	<u>\$ 2,541,331</u>	<u>2,327,871</u>	<u>213,460</u>	<u>9.2%</u>

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

	2007	2006	Total Dollar Change	Total Percentage Change
(in thousands)				
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%
Investment income	433,970	292,816	141,154	48.2%
Other	36,872	39,954	(3,082)	-7.7%
Total additions	<u>1,253,124</u>	<u>1,073,839</u>	<u>179,285</u>	<u>16.7%</u>
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	<u>902,954</u>	<u>860,379</u>	<u>42,575</u>	<u>4.9%</u>
Increase in net assets	<u>\$ 350,170</u>	<u>213,460</u>	<u>136,710</u>	<u>64.0%</u>
(in thousands)				
	2006	2005	Total Dollar Change	Total Percentage Change
Additions				
Contributions:				
Employers	\$ 382,877	371,916	10,961	2.9%
Participating employees	342,697	332,376	10,321	3.1%
Other	15,495	2,907	12,588	433.0%
Investment income	292,816	251,922	40,894	16.2%
Other	39,954	22,656	17,298	76.4%
Total additions	<u>1,073,839</u>	<u>981,777</u>	<u>92,062</u>	<u>9.4%</u>
Deductions				
Retirement and other benefits	804,315	739,439	64,876	8.8%
Refunds of contributions	22,373	19,681	2,692	13.7%
General and administrative	28,534	36,228	(7,694)	-21.2%
Other	5,157	—	5,157	100.0%
Total deductions	<u>860,379</u>	<u>795,348</u>	<u>65,031</u>	<u>8.2%</u>
Increase in net assets	<u>\$ 213,460</u>	<u>186,429</u>	<u>27,031</u>	<u>14.5%</u>

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

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- The System assets exceeded liabilities by \$2,892 million (net assets) for the fiscal year reported compared to the prior year, for which assets exceeded liabilities by \$2,541 million.
- Based on the last actuarial valuation at June 30, 2005, the System funding ratio of the actuarial accrued liability is 19%.
- Loans to plan members amounted to \$577 million at June 30, 2007 compared to \$529 million at June 30, 2006.

The basic financial statement of the System for the fiscal year ended June 30, 2007 presents an increase in net assets of approximately \$350 million as compared to the prior fiscal year. This was mostly the result of an increase in cash and short-term investments of \$255 million, increase in the fair value of investments of \$317 million, increase in loans of \$49 million and in accounts receivable of \$29 million, the decrease in total liabilities of \$195 million due to the cancellation of certain agreements explained below, offset by the sale of the PRTA Holdings Preferred Stock investments of \$495 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 2007, the employer and plan member contributions increased by approximately \$41 million, from \$741 million during fiscal year 2006 to \$782 million during fiscal 2007, which includes Early Retirement of \$15 and \$69 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.

Also the financial statement of the System for the fiscal year ended June 30, 2006 presents an increase in net assets as compared to the fiscal year ended June 30, 2005 of approximately \$213 million. This was mostly the result of an increase in the fair value of investments of \$165 million, increase in PRTA Holdings Preferred Stock investment and loans portfolio of \$72 million, increase in cash and short-term investments of \$12 million and increase in accounts receivable of \$24 million offset by an increase in liabilities of \$60 million.

For fiscal year 2006, the employer and employee contributions increased by approximately \$34 million, from \$707 during fiscal year 2005 to \$741 million during fiscal year 2006.

Master Repurchase Agreement

The Board of Trustees approved on June 28, 2005 a Master Repurchase Agreement for the amount of \$150 million. As of June 30, 2007 the Repurchase Obligation was cancelled.

Credit Agreement

On June 29, 2006, a financial institution (Santander Bank) approved a line of credit of \$112 million. The principal amount borrowed by the System was cancelled as of June 30, 2007.

Investment in PRTA Holdings Preferred Stock

The sale on the investment in PRTA Holdings Preferred Stock took place in April 2007 in the amount of \$529 million and the interest income recognized thereon was \$5 million. These proceeds were used to

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cancel the Master Repurchase Agreement, the line of credit and to cover the overdraft at the Treasury Department.

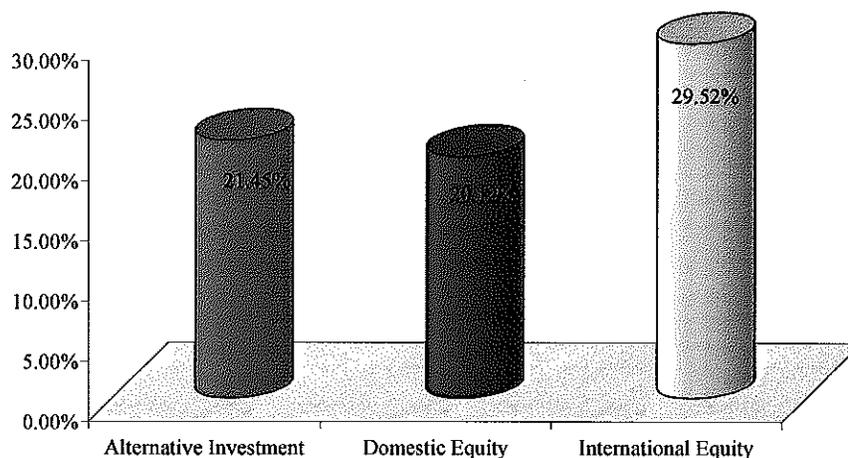
During the fiscal years ended June 30, 2007 and 2006, the System received \$9.9 million and \$45.7 million, respectively, in dividends from TELPRI.

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, 2007 and 2006, 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 performance of International Equity is 29.52%, Alternative Investment is 21.45% and Domestic Equity is 20.12% as shown in the following chart:

**EMPLOYEE'S RETIREMENT SYSTEM OF THE GOVERNMENT
OF THE COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
June 30, 2007



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Management's Discussion and Analysis
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For fiscal year ended June 30, 2006, the investment returns of International Equity was 27.67%, Alternative Investment 23.21% and Domestic Equity 9.75%

Other Investments and Transactions

At June 30, 2007 and 2006, the System held approximately \$577 and \$528 million, respectively, in loans and interest receivable from plan members which represent 23% of the total investment portfolio. As of 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 interest receivable, and \$14 million in allowance for adjustment and losses in realization. For the fiscal year ended June 30, 2006 these loans consist of \$96 million in mortgage loans, \$405 million in personal loans, \$24 million in cultural loans, \$17 million in accrued interests receivable, and \$14 million in allowance for adjustment and losses in realization.

As of June 30, 2007 and 2006, the System has participation in Limited Partnership Investments for an approximate value of \$47.8 and \$41.6 million, respectively which represents 2% of the investment portfolio for each year. These investments had a gross return of 21.45% and 23.21% for fiscal year 2007 and 2006, respectively.

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, 2007 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 2007 and 2006, income from the custodian securities lending activity amounted to approximately \$144,000 and \$158,000, 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

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Management's Discussion and Analysis
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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, 2005, the System's funding ratio is 19%, the actuarial obligation is \$12,284 million, total actuarial value of plan assets amounted to \$2,328 million and the unfunded actuarial accrued liability is \$9,956 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 increase in employee's and employer's contribution rates.

Increase in Benefits for Retirees Established for 2007 and 2006

For the years 2007 and 2006, 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.

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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.

Capital Assets

The System's investment in capital assets as of June 30, 2007 and 2006 amounted to approximately \$8.5 and \$7.7 million, respectively, net of accumulated depreciation. Capital assets include land, building, construction in progress, equipment, furniture and vehicles. 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. See note 8 for further information.

Other Currently Known Facts

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 Board of Trustees authorized to continue the process for this transaction.

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
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Statements of Plan Net Assets

June 30, 2007 and 2006

Assets	2007	2006
	(in thousands)	
Cash and short-term investments		
Deposits at commercial banks	\$ 41,365	27,849
Deposits with Government Development Bank of Puerto Rico:		
Unrestricted	266,633	25,778
Restricted	2,310	2,156
Total cash and short-term investments	310,308	55,783
Investments:		
Bonds	149,639	154,825
Stocks	1,693,144	1,376,901
Private equity investments	47,784	41,609
Total investments	1,890,567	1,573,335
Investment in PRTA Holdings, at appraised value	—	495,318
Total cash and investments	2,200,875	2,124,436
Loans and interest receivable from plan members, net of allowance for adjustments and losses in realization	577,314	528,552
Accounts receivable:		
Employers	117,420	63,571
Commonwealth of Puerto Rico	4,615	10,401
The Commonwealth of Puerto Rico Judiciary Retirement System	5,113	3,161
Investment sales	2,470	1,279
Accrued interest	3,119	2,385
Accrued dividend	—	23,720
Other	4,527	3,351
Total accounts receivable	137,264	107,868
Capital assets	8,476	7,694
Other assets	7,371	7,592
Total assets	\$ 2,931,300	2,776,142

(Continued)

See accompanying notes to basic financial statements.

***Employee's Retirement System of the Government
of the Commonwealth of Puerto Rico***
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Statements of Plan Net Assets
June 30, 2007 and 2006

Liabilities	2007	2006
	(in thousands)	
Deposits with Treasury Department of the Commonwealth	\$ 1,566	—
Securities sold under agreements to repurchase	—	139,074
Line of credit	—	60,000
Funds of mortgage loans and guarantee insurance reserve for loans to plan members	8,914	8,433
Investment purchases	2,172	1,179
Accounts payable and accrued liabilities	10,125	9,246
Other liabilities	17,022	16,879
Total liabilities	<u>39,799</u>	<u>234,811</u>
Net assets held in trust for pension benefits	<u>\$ 2,891,501</u>	<u>2,541,331</u>

(Concluded)

See accompanying notes to basic financial statements.

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*Statements of Changes in Plan Net Assets
Years Ended June 30, 2007 and 2006*

	<u>2007</u>	<u>2006</u>
	(in thousands)	
Additions:		
Contributions:		
Employers	\$ 374,394	382,877
Participating employees	338,791	342,697
Early retirement	69,097	15,495
Other special laws	17,000	16,684
	<u>799,282</u>	<u>757,753</u>
Investment income:		
Net appreciation of investments	364,185	189,515
Dividend income	14,494	49,938
Interest income	68,231	63,486
	<u>446,910</u>	<u>302,939</u>
Less: Investment expense		
Net investment income	<u>12,940</u>	<u>10,123</u>
	433,970	292,816
Insurance premiums on loans to plan members	2,441	14,492
Other income	17,431	8,778
	<u>1,253,124</u>	<u>1,073,839</u>
Deductions:		
Annuities	800,786	772,647
Benefits under other special laws	17,000	16,684
Death benefits	13,872	14,984
Refunds of contributions:		
Employers	5,296	1,666
Participating employees	28,009	20,707
Insurance claims on loans to plan members	2,118	1,216
General and administrative	29,207	28,534
Other expenses	6,666	3,941
	<u>902,954</u>	<u>860,379</u>
Net increase	350,170	213,460
Net assets held in trust for pension benefits		
Beginning of year	<u>2,541,331</u>	<u>2,327,871</u>
End of year	<u>\$ 2,891,501</u>	<u>2,541,331</u>

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)

Notes to Basic Financial Statements

Years Ended June 30, 2007 and 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Employee's Retirement System of the Government of 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 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*. Participating employees and employer's contributions are recognized as additions in the period in which the employee services are rendered. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

During the year ended June 30, 2007 the System adopted the provisions of the Statement of Governmental Accounting Standards Board No. 43 (GASB No. 43), *Financial Reporting for 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.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted 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.

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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 and also expired checks not claimed by the plan members.

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, \$5,000 and \$5,000, respectively.

The System services mortgage loans with aggregate principal balances of approximately \$11.9 and \$14.2 million at June 30, 2007 and 2006, respectively, related to certain mortgages loans sold to Federal National Mortgage Association (FNMA) for a fee of 0.25%. The income for 2007, and 2006 amounted to \$30,622, and \$40,265 respectively, and is recognized as interest income in the accompanying statement of changes in plan net assets.

In addition, as of June 30, 2007 and 2006, the System repurchased approximately \$51,090 and \$98,721, 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.

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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, 2007:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions*, which is effective for fiscal years beginning after December 15, 2006.
- GASB Statement No. 48, *Sales and Pledges of Receivable and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, which is effective for fiscal years beginning after December 15, 2007.
- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which is effective for fiscal years beginning after December 15, 2007

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- GASB Statement No. 50, *Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27*, which is effective for fiscal year beginning after June 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.

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

Reclassifications

Certain reclassifications have been made to the 2006 amounts to conform with current year presentation.

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, 2007 and 2006, membership consisted of the following:

	<u>2007</u>	<u>2006</u>
Retirees and beneficiaries		
currently receiving benefits	99,851	95,221
Current participating employees	<u>107,256</u>	<u>116,018</u>
Total membership	<u><u>207,107</u></u>	<u><u>211,239</u></u>

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

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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 \$300 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.

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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

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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 2004 there have been other acts addressing the cost of living allowance (C.O.L.A.) as 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.

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 the retirement date was prior to January 1, 2004.

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 2006 the Commonwealth of Puerto Rico granted additional benefits to the System's retirees. As of June 30, 2007 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 reach the normal retirement age.

On November 22, 2005 the Commonwealth issued the Act No. 143 which provided an early retirement program for the employees of the Puerto Rico Industrial Development Company (PRIDCO). The actuarial cost of the implementation of the PRIDCO's early retirement program would be paid by PRIDCO prior to the implementation of the program as established in the act.

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

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(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 Tourism's early retirement program would be paid by Tourism prior to the implementation of the program. The Municipality of San Juan would reimburse the annuities and other benefits paid by the System during a five year period plus the employer and employee contributions with respect to the plan members covered until reach the normal retirement age.

As of June 30, 2007, \$18.9 million, \$23.1 million and \$27 million have been received from PRIDCO, Tourism and the Municipality of San Juan, respectively, to amortize the increase in additional annuities paid by the System.

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, 2007 and 2006, System 2000 membership within the System's total membership consisted of the following:

	<u>2007</u>	<u>2006</u>
Current participating employees	<u>69,581</u>	<u>60,324</u>

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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 \$117.9 and \$113.6 million in 2007 and 2006, respectively, to cover special laws. The additional contributions are accounted as reduction of benefits payments, except for approximately \$17 million and \$16.7 million in 2007 and 2006, 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 budget by the Commonwealth through legislative appropriations.

As of June 30, 2007 and 2006 the System believes that they had to cover approximately \$73.9 million, for each year, of costs from its resources that should have been received through special laws. From these costs, as of June 30, 2007 and 2006 there were \$3 and \$4.1 million, respectively, included in the financial statements as receivables from the Commonwealth of Puerto Rico; the remaining amount has not been accrued pending a final review by the System and the acceptance by the Office of Management and Budget of the Commonwealth.

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 Board of Trustees authorized to continue the process for this transaction.

Actuarial Information

Calculations of the present value of benefits under the System were made by consulting actuaries as of June 30, 2005, using the projected unit credit actuarial cost method. Significant assumptions underlying the actuarial computations include: (a) assumed rate of return on investments of 8.5%, (b) assumed compound rate of wage increases of 5% per year, and (c) assumed mortality rate based on the Group Annuity Table for 1983.

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As of June 30, 2005 the actuarial accrued liability and the unfunded actuarial accrued liability were approximately \$12,284 and \$9,956 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 \$1,525,000 and \$1,536,000 which represented its contractually required contribution for the years ended June 30, 2007 and 2006, respectively.

4. CASH AND INVESTMENTS

Custodial Credit Risk Related to Deposits

As of June 30, 2007 and 2006, the System's custodial credit risk was approximately \$275.4 million and \$44.0 million, respectively, related to the bank balance of cash and short-term investments deposited at GDB for Puerto Rico. 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.

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Investments

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

	<u>2007</u>	<u>2006</u>
	(in thousands)	
Bonds:		
US Government and agencies' securities		
Not Under Repurchase Agreement	\$ 96,879	202
Under Repurchase Agreement	—	91,504
Total US Government and agencies' securities	<u>96,879</u>	<u>91,706</u>
US Corporate bonds		
Not Under Repurchase Agreement	52,760	6,465
Under Repurchase Agreement	—	56,654
Total US Corporate bonds	<u>52,760</u>	<u>63,119</u>
Total bonds	<u>149,639</u>	<u>154,825</u>
Equity Investments:		
US Corporate stocks	1,137,987	948,269
Non-US Corporate stocks	555,157	428,632
Total stocks	<u>1,693,144</u>	<u>1,376,901</u>
Private equity investments	47,784	41,609
Total equity investments	<u>1,740,928</u>	<u>1,418,510</u>
Total investments	<u>\$ 1,890,567</u>	<u>1,573,335</u>

Cash and short-term investments include approximately \$148.2 million as of June 30, 2006 held as pledged collateral by a custodian bank in connection with a master repurchase agreement which was executed on June 29, 2007, liquidating such liability and liberating the associated collateral (see note 9).

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, 2007.

Custodial Credit Risk Related to Investments

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2007 and 2006 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.

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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 table presents the bonds Moody's ratings as of June 30, 2007 and 2006, respectively (in thousands):

Moody's Rating	Investment Type	Fair Value	
		2007	2006
AAA	US Government and Agencies Securities	\$ 96,879	84,702
AAA	Corporate Bonds	990	1,045
AA1	Corporate Bonds	2,344	2,710
AA3	Corporate Bonds	12,522	11,508
A1	Corporate Bonds	4,414	5,420
A2	Corporate Bonds	5,229	2,574
A3	Corporate Bonds	4,449	6,826
BAA1	Corporate Bonds	2,653	5,429
BAA2	Corporate Bonds	7,279	12,584
BAA3	Corporate Bonds	8,886	4,264
BA1	Corporate Bonds	—	2,130
B1	Corporate Bonds	—	3,810
B2	Corporate Bonds	—	1,125
B3	Corporate Bonds	—	3,694
CAA1	Corporate Bonds	3,994	—
NR	GNMA	—	7,004
	Total bonds	\$ 149,639	154,825

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.

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

	Maturity from	Fair Value	Investment Maturities (In Years)			
			Less than 1	1-5	More than 5-10	More than 10
U.S Government and agencies securities	(2007-2033)	\$ 96,879	86,038	—	4,939	5,902
Corporate bonds	(2007-2035)	52,760	—	22,817	15,432	14,511
Total bonds		\$ 149,639	86,038	22,817	20,371	20,413

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

Maturity	Maximum Maturity
Less than one year	57%
One to five years	15%
More than five to ten years	14%
More than ten years	14%

Foreign Currency Risk

As of June 30, 2007 and 2006, the System owned approximately \$555 and \$428 million, respectively, in an international equity commingled fund under the custody of Morgan Stanley investment bank, which represented approximately 74.11% and 74.03%, respectively, of the total commingled fund. As of June 30, 2007 this pooled trust has an asset mix and country allocation as shown in the following table:

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<u>Assets Mix</u>			<u>2007</u>	<u>2006</u>
			<u>Percent</u>	<u>Percent</u>
Cash and Short Term Investments			1.51	0.94
Future Contracts			12.14	8.76
<u>Equity Securities</u>			<u>86.35</u>	<u>90.30</u>
Total			100.00	100.00
<u>Country Allocation</u>	<u>Currency</u>	<u>Currency Code</u>	<u>Portfolio %</u>	<u>Portfolio %</u>
Poland	Zlotych	PLN	0.61	0.49
Russia	Rubles	RUB	0.99	1.51
Eastern Europe			<u>1.60</u>	<u>2.00</u>
Austria	Euro	EUR	1.00	0.78
Belgium	Euro	EUR	0.55	0.63
Finland	Euro	EUR	0.95	1.22
France	Euro	EUR	9.39	8.31
Germany	Euro	EUR	11.61	9.98
Greece	Euro	EUR	0.24	0.24
Ireland	Euro	EUR	0.05	-
Netherlands	Euro	EUR	2.47	2.51
Italy	Euro	EUR	0.99	-
Portugal	Euro	EUR	0.16	0.14
Spain	Euro	EUR	2.02	2.27
Euro Europe			<u>29.43</u>	<u>26.08</u>
Brazil	Real	BRL	1.93	1.27
Colombia	Pesos	COP	0.05	-
Mexico	Pesos	MXN	1.05	0.50
Latin America			<u>3.03</u>	<u>1.77</u>
Cyprus	Pounds	CYP	0.04	-
Turkey	Lira	TRY	0.22	0.71
Middle East			<u>0.26</u>	<u>0.71</u>
Denmark	Kroner	DKK	0.41	0.40
Norway	Kroner	NOK	1.32	0.45
Sweeden	Krona	SEK	2.61	2.13
Switzerland	Francs	CHF	4.72	5.23
United Kingdom	Pounds	GBP	17.85	20.27
Non-Euro Europe			<u>26.91</u>	<u>28.48</u>
Australia	Dollars	AUD	3.81	3.65
China	Yuan Renmimbi	CNY	1.80	-
Hong Kong	Dollars	HKD	1.26	3.38
Indonesia	Rupiahs	IDR	0.48	-
Japan	Yen	JPY	24.72	29.70
Malasya	Ringgits	MYR	0.08	-
New Zealand	Dollars	NZD	0.01	0.01
Singapore	Dollars	SGD	2.14	1.80
South Korea	Won	KRW	0.56	-
Thailand	Baht	THB	0.00	0.43
Taiwan	New Dollars	TWD	0.14	-
Pacific			<u>35.00</u>	<u>38.97</u>
Emu	Euro	EUR	0.60	0.60
South Africa	Rand	ZAR	0.14	0.45
India	Rupees	INR	1.52	-
Other			<u>2.26</u>	<u>1.05</u>
Cash			1.51	0.94
Total			100.00	100.00

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Investments in Limited Partnerships

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

	<u>Date of Commitment</u>	<u>Total Commitment</u>	<u>FY 07 Contributions</u>	<u>Contributions to Date at Cost</u>	<u>Estimated Value</u>
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.e.)	Jul. 1998	1,796	—	1,796	—
Total alternative investments		<u>\$ 117,596</u>	<u>9,389</u>	<u>76,211</u>	<u>47,784</u>

As of June 30, 2006, the System had capital commitments and contributions as follows (in thousands):

	<u>Date of Commitment</u>	<u>Total Commitment</u>	<u>FY 06 Contributions</u>	<u>Contributions to Date at Cost</u>	<u>Estimated Value</u>
Grupo Guayacán, Inc.					
Guayacán Fund of Funds, LP	Sept. 1996	\$ 25,000	—	23,279	9,246
Guayacán Fund of Funds II, LP	Aug. 1999	25,000	—	19,639	16,916
Advent-Morro Equity Partner, Inc.					
Guayacán Private Equity Fund, LP	Jan. 1997	5,000	477	4,407	5,234
Venture Capital Fund, Inc.	Nov. 1995	800	—	800	737
Chase Capital Partners Private Equity Fund of Funds Corporate Investors II, LTD	Jul. 2000	20,000	1,266	16,307	9,476
Martineau Bay Resort, s. en c. (s.e.)	Jul. 1998	1,796	—	1,796	—
Total alternative investments		<u>\$ 77,596</u>	<u>1,743</u>	<u>66,228</u>	<u>41,609</u>

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The fair value of investments in limited partnerships as of June 30, 2007 and 2006 amounted to approximately \$47.8 and \$41.6 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 2007, \$224 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. There were no contributions to this fund during fiscal year 2006.
- During fiscal year 2007, \$3.8 million 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. There were no contributions to this fund during fiscal year 2006.
- During fiscal year 2007, there were no contribution 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. Total contributions for fiscal year 2006 amounted to approximately \$477 thousand.
- During fiscal year 2007, \$1.2 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.
- During fiscal years 2007 and 2006 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

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combination 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 2007, \$3.1 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.
- During fiscal year 2007 and 2006, \$1.1 and \$1.3 million, respectively, 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.

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

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, 2007 and 2006, the collateral received represents 103.88% and 103.23%, respectively, of the fair value of the securities lent.

Securities lending obligations for which collateral was received at June 30, 2007 and 2006 consisted of the following (in thousands):

	Fair Value	
	2007	2006
Securities Lent		
US. Equity	\$ 61,844	35,885

The underlying collateral for these securities had a market value of approximately \$64.2 and \$37 million as of June 30, 2007 and 2006, respectively, and was invested as follows (in thousands):

	2007		2006	
Asset Backed Commercial Paper	\$ 9,369	14.58%	937	2.53%
Reverse Repo U.S. Agency Delivered	6,154	9.58%	5,191	14.01%
Certificate of Deposits	—	0.00%	2,811	7.59%
Reverse Repo Mortgage Backed Tri- Party	48,720	75.84%	28,108	75.87%
Total	\$ 64,243	100.00%	37,047	100.00%

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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.

5. 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.

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):

	<u>2007</u>	<u>2006</u>
Loans receivable:		
Mortgage	\$ 107,680	96,544
Personal	439,854	405,756
Cultural trips	<u>27,813</u>	<u>23,762</u>
Total loans to plan members	575,347	526,062
Accrued interest receivable	<u>16,200</u>	<u>16,727</u>
	591,547	542,789
Less: Allowance for adjustments and losses in realization	<u>(14,233)</u>	<u>(14,237)</u>
Total loans receivable, net	<u>\$ 577,314</u>	<u>528,552</u>

6. 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.

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The total amount included as receivable as of June 30, 2007, 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.

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, 2007 and 2006, the receivable from employers amounted to \$117.4 and \$63.6 million, respectively.

7. INVESTMENT IN PRTA HOLDINGS

On August 4, 1997, the Senate of Puerto Rico approved Law No. 54, which authorized the Government to commence negotiations to sell the Puerto Rico Telephone Company (PRTC or TELPRI). On June 24, 1998, the Senate and the House of Representatives issued Joint Resolution 209 to authorize the final sale of 50% plus one share of the stock of TELPRI to a joint venture created between GTE Holdings (Puerto Rico) LLC (a subsidiary of Verizon Communications) and Banco Popular de Puerto Rico (the Buyers) and to designate the use of the sale proceeds.

In the same resolution, it was established that the shares of TELPRI's common stock that were not sold on the Closing Date of the First Sale, as defined in the Resolution, should be transferred to the GDB, and further, it also instructed GDB to create a subsidiary to hold and dispose of that stock for the benefit of the System. The First sale took place on March 2, 1998. After the First sale, the Commonwealth retained 43% of TELPRI's stock.

Subsequently, GDB created a subsidiary, known as PRTA Holdings and transferred the TELPRI'S stock retained by the Commonwealth to that subsidiary. On December 28, 2000, PRTA Holdings issued and assigned its non-cumulative, non-voting preferred stock to the System, entitling the System to receive the benefits that the TELPRI's stock would generate in the future. PRTA Holdings' capital structure consists of 100 shares of common stock at \$0.01 each owned by GDB and 100 shares of non-convertible, non-voting preferred stock, owned by the System. As established by the Articles of Incorporation of PRTA Holdings, the product of the future sale of any shares of the TELPRI stock and any dividends declared by TELPRI will benefit the System. During the years ended June 30, 2007 and 2006, the System received \$9.9 and \$40.7 million, respectively, consisting of the dividends declared and paid by TELPRI.

In connection with the First Sale of TELPRI's stock on March 2, 1998, the Buyer was granted an option, to purchase an additional 15% of the TELPRI's stock at a fixed price of \$45.94 per share, expiring on March 2, 2002. The Buyer exercised the option on January 25, 2002. The total proceeds from the exercise of this option amounted to \$172 million.

On March 30, 2007 PRTA Holdings sold to Sercotel, S.A. the remaining TELPRI's stocks at a fixed price of \$75.60931 per share. Total proceeds from the sale amounted to \$529.3 million. The book value of the stocks was \$495.3 million, resulting in a realized gain of \$34 million. The proceeds of

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this transaction were used to: (1) repay the liability associated to the securities sold under agreements to repurchase, (2) repay the line of credit with the Santander Bank, and (3) to cover the bank overdraft at the Treasury Department. (See notes 10 and 11)

8. CAPITAL ASSETS

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	<u>969</u>	<u>1,375</u>	<u>—</u>	<u>2,344</u>
Capital assets, being depreciated:				
Building and improvements	7,631	—	—	7,631
Equipment	12,780	295	117	12,958
Total capital assets, being depreciated	<u>20,411</u>	<u>295</u>	<u>117</u>	<u>20,589</u>
Less accumulated depreciation for:				
Building and improvements	3,342	113	—	3,455
Equipment	10,344	770	112	11,002
Total accumulated depreciation	<u>13,686</u>	<u>883</u>	<u>112</u>	<u>14,457</u>
Total capital assets being depreciated, net	<u>6,725</u>	<u>(588)</u>	<u>5</u>	<u>6,132</u>
Total capital assets, net	<u>\$ 7,694</u>	<u>787</u>	<u>5</u>	<u>8,476</u>

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Years Ended June 30, 2007 and 2006

Capital assets activity for the year ended June 30, 2006 was as follows (in thousands):

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 969	—	—	969
Capital assets, being depreciated:				
Building and improvements	7,631	—	—	7,631
Equipment	12,677	186	83	12,780
Total capital assets, being depreciated	20,308	186	83	20,411
Less accumulated depreciation for:				
Building and improvements	3,229	113	—	3,342
Equipment	9,637	790	83	10,344
Total accumulated depreciation	12,866	903	83	13,686
Total capital assets being depreciated, net	7,442	(717)	—	6,725
Total capital assets, net	\$ 8,411	(717)	—	7,694

9. OTHER ASSETS

At June 30, 2007 and 2006, other assets consisted of the following (in thousands):

	2007	2006
Repossessed and foreclosed properties	\$ 2,672	2,893
Executed land	4,699	4,699
Total	\$ 7,371	7,592

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, 2007 and 2006, 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.

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10. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

During fiscal year 2005, securities underlying agreements to repurchase were delivered to, and are being held by, the counterparties with whom the repurchase agreements were transacted. The counterparties have agreed to resell to the System the same securities at the maturity of the agreements. The System may be required to provide additional collateral based on the fair value of the underlying securities.

On June 29, 2007 the System executed the repurchase agreement with the counterparty, liquidating the liability associated with this transaction and liberating the associated collateral, using the sales proceeds of the investment in PRTA Holdings (see note 7).

The following table presents the liability associated with the repurchase transactions, the amortized cost and market value of the collateral as of June 30, 2006 (in thousands):

	Fiscal Year 2006		
	<u>Repurchase Liability</u>	<u>Amortized cost of collateral</u>	<u>Market value of collateral</u>
U.S. Treasury securities	\$ 63,944	64,528	64,839
U.S. Government agencies securities	19,362	19,987	19,863
Collateralized mortgage obligations	7,200	7,017	6,802
Corporate bonds	48,568	53,379	56,654
Total	<u>\$ 139,074</u>	<u>144,911</u>	<u>148,158</u>

11. LINE OF CREDIT

The System entered into a credit agreement with a financial institution as of June 29, 2006 in which loans could be made from time to time in the aggregate principal amount not exceeding \$112 million at any time outstanding, at a variable rate subject to LIBOR plus the Applicable Margin (50 basis points in the case of LIBOR rate or 0 basis points in the case of Base Rate Advances). As of June 30, 2006 the outstanding balance of the line of credit was approximately \$60 million, however this balance was paid on June 29, 2007 with the sales proceeds of the investment in PRTA Holdings (see note 7).

12. 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.

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13. 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 \$73.9 million from its resources that the System believes should have been received through special laws appropriations. As of 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.

14. 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, 2007.

* * * * *

***Required Supplementary Schedules of Employers'
Contributions and Funding Progress***

***Employee's Retirement System of the Government
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(A Pension Trust Fund of the Commonwealth of Puerto Rico)

Schedule of Employer's Contribution

June 30, 2007

(In Thousands)

<u>Year Ended June 30,</u>	<u>Annual Required Contributions</u>	<u>Contributions</u>	<u>Percentage Contributed</u>	<u>(Excess)/ Deficiency</u>
2007	\$ Not available	443,491	N/A	—
2006	564,217	398,372	71%	(165,845)
2005	578,387	374,823	65%	(203,564)
2004	578,387	330,336	57%	(248,051)
2003	802,536	330,404	41%	(472,132)
2002	802,536	308,228	38%	(494,308)
2000	890,800	549,855	62%	(340,945)
1999	845,000	491,800	58%	(353,200)

Annual Required Contribution for the year ended June 30, 2001 is not available.
Information prior to June 30, 2001 is from June 30, 2001 Audited Financial Statements.

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

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Schedule of Funding Progress

June 30, 2007

(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, 2005	\$ 2,327,871	12,283,865	9,955,994	19%	4,125,866	241%
June 30, 2004	2,141,442	—	—	N/A	—	N/A
June 30, 2003	1,947,402	11,191,357	9,243,955	17%	3,334,441	277%
June 30, 2002	1,979,677	—	—	N/A	—	N/A
June 30, 2001	2,428,664	9,881,481	7,452,817	25%	2,549,446	292%
June 30, 2000	2,041,800	9,459,300	7,417,500	22%	2,463,400	301%
June 30, 1999	1,858,000	8,308,000	6,450,000	22%	2,575,000	250%

Annual Required Contribution for the year ended June 30, 2001 is not available.

Information prior to June 30, 2001 is from June 30, 2001 Audited Financial Statements.

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

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Notes to Supplementary Schedules of

Employer's Contribution and Funding Progress

June 30, 2007

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 includes both Commonwealth's and participating employee's contributions as the Commonwealth's contributions, ultimately, should cover any deficiency between the participating employee's contributions, the pension benefits and the System's administration costs.

The information was obtained from last actuarial report as of June 30, 2005.

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, 2005.

3. ACTUARIAL DATA

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Starting July 1, 2001, the actuarial valuation is being performed every two years. Additional information as of the latest actuarial valuation follows:

Valuation Date	June 30, 2005
Actuarial Cost Method	Projected unit credit cost method
Amortization Method	Level percent of pay
Remaining Amortization Period	21 years
Asset Valuation Method	Market value
Actuarial Assumptions:	
Investment rate of return*	8.50%
Projected salary increases*	5.00%
Mortality rate	Group Annuity Mortality Table for 1983
Cost of living adjustment	None

* Includes inflation at 3.50%

* * * * *