AUDITED FINANCIAL STATEMENTS

University of Puerto Rico Retirement System
Years Ended June 30, 2007 and 2006
With Report of Independent Auditors

University of Puerto Rico Retirement System

Audited Financial Statements

Years Ended June 30, 2007 and 2006

Contents

Ernst & Young

Ernst & Young LLP
1000 Scotiabank Plaza
273 Ponce de Leon Avenue
Hato Rey, Puerto Rico 00917-1951

Phone: (787) 759-8212
Fax: (787) 753-0808
Fax: (787) 753-0813
www.ey.com

Report of Independent Auditors

The Board of Trustees
of the University of Puerto Rico Retirement System

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

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the System's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 10, 2008, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis and the required supplementary information, as listed in the table of contents, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Ernst & Young LLP

March 10, 2008

Stamp No. 2273571
affixed to
the original
of this report.

University of Puerto Rico Retirement System

Management's Discussion and Analysis (Unaudited)

Year Ended June 30, 2007

Our discussion and analysis of the University of Puerto Rico Retirement System (the System) financial performance provides an overview of the System's financial activities for the fiscal years ended June 30, 2007, 2006 and 2005.

Financial Highlights

- System's assets exceeded liabilities by **$1,002.1** million, **$869.3** million and **$806.2** million at the close of fiscal years 2007, 2006 and 2005, respectively (reported as net assets). Net assets are held in trust to meet future benefit payments.

- The components of Additions to Plan Net Assets in the year 2007 are comprised of contributions of **$118,340,711,** investment income of **$128,702,010,** and **$8,196,843** in reimbursements from the University of Puerto Rico for Medical Insurance.

- Additions to Plan Net Assets increased for the fiscal years 2006 to 2007 from **$179,232,044** to **$255,239,564** respectively, representing an addition of **$76,007,520** or **42.40%**. The main reason for the increase is net appreciation of investments of **$68,510,771** or **190.00%** from fiscal year 2006 to 2007. In addition, employee contributions increased from **$38,709,632** to **$40,029,937** from fiscal year 2006 to 2007 to accrue contributions related to Certification No. 94, and 139 in the amount of $**2,864,226.**

- Additions to Plan Net Assets increased from fiscal year 2005 to 2006 from **$174,487,731** to **$179,232,044**, representing an addition of **$4,744,313** or **2.72%**. The main reason for the addition was an increase in net appreciation of investments of **$4,155,706** or **13.02%** from fiscal year 2005 to 2006. In addition, employee contributions increased from **$36,464,395** to **$38,709,632** from fiscal year 2005 to 2006, mainly due to an increase in salaries.

- Deductions to plan net assets increased from fiscal year 2006 to 2007 from **$116,111,947** to **$122,471,336** or **5.47%.** The main reason for the increase corresponded to an increase in the amount of retirees of **148**. From fiscal year 2005 to 2006 deductions increased **$4,093,340** or **3.65%**. The main reason for the increase corresponded to an increase in the amount of retirees of 100. From fiscal year 2004 to 2005 deductions increased **$7,310,134** or **7%**. The main reason for the increase corresponded to an increase in the amount of retirees of **96** and a **3%** increase in individual benefits compensation.

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

These statements include all assets and liabilities using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Plan Net Assets presents plan assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets measure whether the System's financial position is improving or deteriorating. The statement of Changes in Plan Net Assets presents how the System's net assets changed during the period to determine whether the System is becoming financially stronger or weaker and to understand changes over time in the funded status of the System.

Financial Analysis

The net assets during the year ended June 30, 2007 increased by approximately **$132.7** million or **15.27%** from the prior year (see Statements of Change in Plan Net Assets for details). For the fiscal year 2007 total assets increased **$158.7** million or **17.98%** from the prior year. The net assets during the year ended June 30, 2006 increased by approximately **$62.9** million or **7.68%** from the prior year. The increase in plan net assets is attributed principally to gain on sales of investments approximately **$39.9** million and, interest and dividends of approximately **$26.6 million.** For the fiscal year 2006 total assets increased **$62.9** million or **7.68%** from the prior year. The increase in plan net assets is attributed principally to gain on sales of investments approximately **$51** million and a disfavorable market condition and other income of $14.9 million for a net of $33.1, and interest and dividends of approximately **$25.1 million.** For the fiscal year 2005 total assets increased **$62.6** million or **8.27%** from the prior year.

	June 30, 2005	June 30, 2006	June 30, 2007	2005-2006 Percentage Change	2006-2007 Percentage Change
Assets					
Cash	$ 46,316,522	**$ 35,426,193**	**$ 35,614,758**	(23.51)%	0.53%
Receivables	3,071,769	**7,810,504**	**15,601,067**	154.27%	99.74%
Investments, at fair value	643,910,025	**711,147,146**	**856,030,253**	10.44%	20.37%
Private equity funds	9,010,240	**10,596,181**	**10,972,151**	17.60%	3.55%
Loans to plan members	117,204,910	**116,170,111**	**121,714,064**	(0.88)%	4.77%
Property and equipment, net	77,112	**1,355,251**	**1,324,991**	1657.50%	16.58%
Other assets	113,200	**113,200**	**80,100**	0.00%	(29.24)%
Total Assets	819,703,778	**882,618,586**	**1,041,337,384**	7.68%	17.98%
Liabilities					
Accounts payable and accrued expenses	3,194,651	**3,658,034**	**3,833,286**	14.50%	4.79%
Escrow deposits on mortgage loans	207,277	**67,325**	**76,643**	(67.52)%	13.84%
Other deposits	2,911,883	**3,488,132**	**3,680,355**	19.79%	5.51%
Payables for acquisition of investments	7,160,802	**6,055,833**	**31,629,610**	(15-43)%	422.30%
Total Liabilities	13,474,613	**13,269,324**	**39,219,894**	(1.52)%	195.57%
Total Net Assets	$806,229,165	**$869,349,262**	**$1,002,117,490**	7.83%	15.27%

	June 30, 2005	June 30, 2006	June 30, 2007	2005-2006 Percentage Change	2006-2007 Percentage Change
Additions:					
Contributions	$105,755,430	**$112,367,715**	**$118,340,711**	6.3%	5.3%
Investment income	58,718,232	**59,104,928**	**128,702,010**	0.7%	117.8%
Medical insurance reimbursements from the University of Puerto Rico	7,778,469	**7,759,401**	**8,196,843**	(0.2)%	5.6%
3% increase in pension benefits reimbursement from the University of Puerto Rico – Administración Central	2,235,000	–	–	100.0%	–
Total additions	174,487,131	**179,232,044**	**255,239,564**	2.7%	42.4%
Deductions:					
Benefits paid to participants	100,459,327	**105,089,895**	**110,831,424**	4.6%	5.5%
General and Administrative expenses	3,780,811	**3,262,651**	**3,443,069**	(13.7)%	5.5%
Medical insurance expenses paid to retirees	7,778,469	**7,759,401**	**8,196,843**	-0.2%	5.6%
Total deductions	112,018,607	**116,111,947**	**122,471,336**	3.7%	5.5%
Net increase (decrease) in net assets held in trust for pension benefits	$ 62,468,524	**$ 63,120,097**	**$132,768,228**	1.0%	110.3%

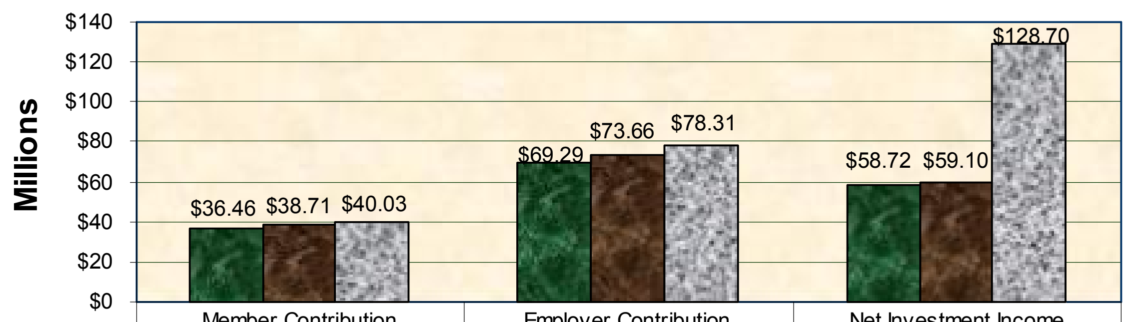
Contributions

The funds needed to finance retirement benefits are obtained through employer and employee contributions and through earnings on investments. Contributions and net investment income for fiscal year 2007 amounted to approximately **$247.0** million, which represents an increase of approximately **$75.5** or **44.0%** over the prior year. The major reason is due to the increase in the required contributions and the increase on gain on investments and, interest and dividends due to market conditions. Contributions and net investment income for fiscal year 2006 amounted to approximately **$171.5** million.

Contributions from employer increased by approximately **$4.6** million or **6.3%** due to an increase in the amount of hired employees during the year and an increase in salaries. Contributions from employer during fiscal year 2006 increased by approximately $**4.4** million due to an increase in the amount of hired employees during the year increase in salaries. The contribution rate is equal to the prior years 2006 and 2005 of 15%. Contributions from employer during fiscal year 2005 increased by approximately **$7.9** million due to an increase in the amount of hired employees during the year.

Contributions paid by employees approximated **$40.0** and **$38.7** million for the years ended June 30, 2007, and 2006, respectively. This represented an increase of approximately **$1.3** million or **3.4%.** The increase was the result of the recognition of **$1,320,305** in the participants' contributions related to certifications No. 139 and No. 94. Contributions paid by employees approximated **$38.7** and **$36.4** million for the years ended June 30, 2006, and 2005, respectively. This represented an increase of approximately **$2.3** million or **6%.** The increase was the result of an increase in contributions over the prior year due to the increase in salaries and the recording of participants' contributions related to certifications No. 139 and No. 140. This represented a decrease of approximately **$4.6** million or **11%.** The decrease was the result of the recognition of $6,450,036 in the participants' contributions related to certifications No. 139 and No. 94 in 2004.

Total Additions to Plan Net Assets
(in Millions)



	Member Contribution	Employer Contribution	Net Investment Income
2005	$36,464,035	$69,291,395	$58,718,232
2006	$38,709,632	$73,658,083	$59,104,928
2007	$40,029,937	$78,310,774	$128,702,010

Operating Expenses

Total operating expenses for the System during fiscal year 2007 amounted to **$3,443,069**, an increase of **$180,418** or **5.53%** from the amount in fiscal year 2006. This difference resulted from increase by **$180,418** in the rent expenses, legal expenses and advisory medical expenses. Total operating expenses for the System during fiscal year 2006 amounted to **$3,262,651**, an increase of **$518,160** or **13.7%** from the amount in fiscal year 2005. This difference resulted form a decreased by **$596,704** in the allowance for doubtful accounts charged to operations during the fiscal year 2005. Total operating expenses for the System during fiscal year 2005 amounted to **$3,780,811**, an increase of **$1,105,690** or **41.3%** from the amount in fiscal year 2004. This difference resulted from an increase of **$508,986** in the employees' salaries, legal expenses, legal and advisory medical expenses, increase in the investments expenses and, an increase of **$596,704** in allowance for doubtful account during the year.

Investments

The System's investment portfolio during fiscal year 2007 appreciated in fair value by approximately **$144.8** million, as compared to fiscal year 2006 when it depreciated approximately **$15.1** million. This amount includes realized gain on sales of investments amounting to approximately **$39.9** million during fiscal year 2007. Total investment expenses during fiscal year 2007 of **$2,546,568** increased by **$525,139** or **26%** as compared to fiscal year 2006.

The System's investment portfolio during fiscal year 2005 appreciated in fair value by approximately **$31.9** million, as compared to fiscal year 2004 when it appreciated approximately **$48.9** million. This amount includes realized gain on sales of investments amounting to approximately **$10.8** million during fiscal year 2005. Total investment expenses during fiscal year 2005 of **$2,037,569** increased by **$79,490** or **4.1%** as compared to fiscal year 2004.

The System's investment portfolio during fiscal year 2006 appreciated in fair value by approximately **$15.1** million, as compared to fiscal year 2005 when it appreciated approximately **$31.9** million. This amount includes realized gain on sales of investments amounting to approximately **$51.1** million during fiscal year 2006. Total investment expenses during fiscal year 2006 of **$2,021,249** decreased by **$16,320** as compared to fiscal year 2005.

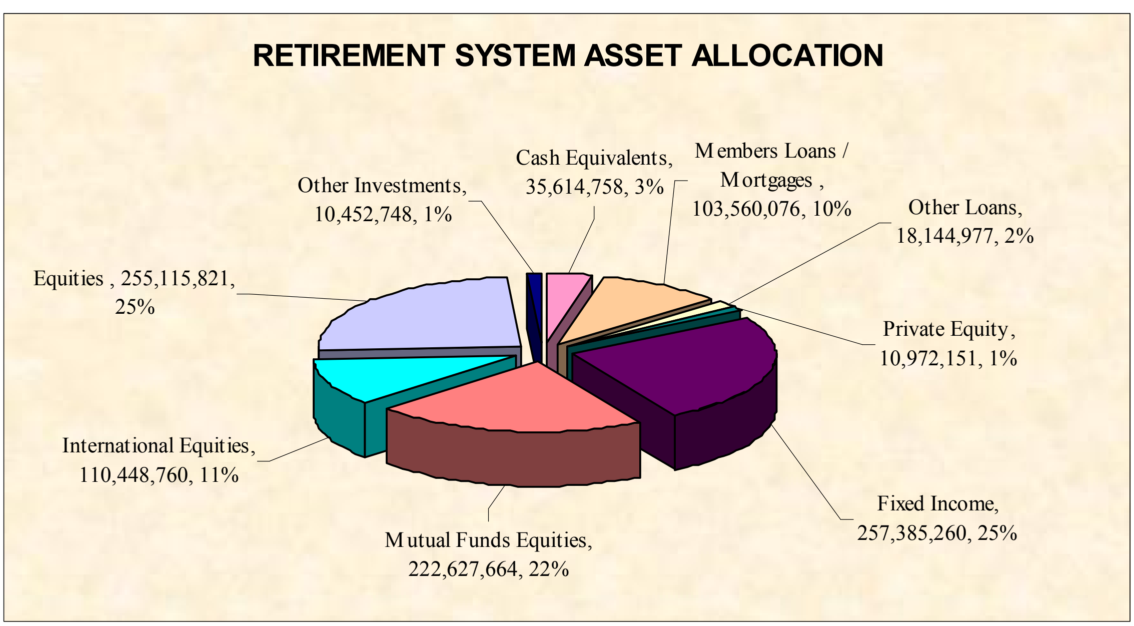
The net investment income for fiscal year 2007 amounted to **$128.7** million, an increase of **$69,597,082** or **118%** compared to a net investment income of **$59.1** in fiscal year 2006 due to an increase in net appreciation in fair value of investments and a decrease on investments expenses.

The net investment income for fiscal year 2006 amounted to **$59.1** million, an increase of **$386,696** or **.7%** compared to a net investment income of **$58.7** in fiscal year 2005 due to an increase in net appreciation in fair value of investments and a decrease on investments expenses.

The net investment income for fiscal year 2005 amounted to **$58.7** million, a decrease of **$17.0** or **22.5%** compared to a net investment income of **$75.7** in fiscal year 2004 due to a decrease in net appreciation in fair value of investments and an increase on investments expenses.

Retirement System of Puerto Rico Asset Allocation

The System's investments comprise approximately **98%** of the total plan assets. Most of the assets are invested in long-term investments. The investment fund has **57%** of its assets in stocks and **25%** in fixed income investments, **3%** in cash equivalents, **10%** loans to members and **5%** in other investments. Equity investments are diversified between domestic and foreign markets and among companies with small, medium and large capitalization. The table below shows the asset allocation as of June 30, 2007:



Benefits Paid and Liabilities

Pension Benefits paid to retirees and beneficiaries were approximately **$110.8** million, which represents an increase of approximately **$5.7** million or **5.4%** when compared to the prior year. For the fiscal year 2006, Pension Benefits paid to retirees and beneficiaries were approximately **$105**.1 million, which represents an increase of approximately **$4.6** million or **4.6%** when compared to the prior year. For the fiscal year 2005, Pension Benefits paid to retirees and beneficiaries were approximately **$100.5** million, which represents an increase of approximately **$6.3** million or **6.7%** when compared to the prior year. The increase is related to additional benefits due Certification No. 130 (2003-2004) who increase of 3% of the benefits retirees effective on July 1, 2004 and increase in the number of retirees.
As of June 30, 2007, the **Active members** and **Retired members** were **12,550** and **6,656,** respectively, as compared to **12,590 and 6,508** as of June 30, 2006. As of June 30, 2006, the active and retired members were **12,590** and **6,508,** respectively, as compared to **13,075** and **6,408** as of June 30, 2005.

The total liabilities were **$39.2** millions, which represents an increase of **$25,950,569** or **195%** when compared to prior year. During fiscal year 2006 the total liabilities were **$13.3** millions, which represent a decrease of **$205,289** or **1.5%** when compared to prior year. During fiscal year 2005 the total liabilities were **$13.5** million, which represents an increase of **$119,924** or **0.90%** when compared to prior year. The amount represents accounts payables to agencies, deposits for distribution to employee's contributions and accounts payables for acquisition of investments.

Retirement System as a Whole

The System's net assets increased consistently over the last five years. Management believes, and actuarial studies concur, that the System is in a financial position to meet its current obligations. We believe the current financial position will continue to improve due to a prudent investment program, an effective cost control program, and strategic planning.

Contacting System's Financial Management

This financial report is designed to provide the Retirement Board and Trustees Board, our membership, taxpayers, investors, and creditors with general overviews of the System's finances and to demonstrate the System's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the University of Puerto Rico Retirement System at PO Box 21769, San Juan, Puerto Rico 00931-1769. (787) 751-4550 or (787) 764-5438 Direct.

University of Puerto Rico Retirement System

Statements of Plan Net Assets

	June 30 2007	June 30 2006
Assets		
Cash and investments:		
Cash, cash equivalents and short-term investments	**$ 35,614,758**	$ 35,426,193
Marketable securities	**856,030,253**	711,147,146
Private equity funds	**10,972,151**	10,596,181
Loans to plan members:		
First mortgages	**36,781,162**	34,416,923
Personal installments	**66,787,905**	63,479,940
Other, net of allowance for doubtful account of $ 220,169 in 2007 and $248,530 in 2006	**18,144,997**	18,273,248
	121,714,064	116,170,111
Total cash and investments	**1,024,331,226**	873,339,631
Receivables:		
Accrued interest receivable on investments	**2,690,817**	1,530,887
Receivables from sale of investments	**12,063,106**	5,882,882
Contributions receivable from Puerto Rico Treasury Department	**390,145**	7,379
Accounts receivable from University of Puerto Rico Central Administration	**206,836**	188,682
Other receivables	**250,163**	200,674
Total receivables	**15,601,067**	7,810,504
Capital assets, net of accumulated depreciation of $517,496 in 2007 and $465,836 in 2006	**1,324,991**	1,355,251
Other assets	**80,100**	113,200
Total assets	**1,041,337,384**	882,618,586
Liabilities		
Accounts payable and accrued expenses	**3,833,286**	3,658,034
Escrow deposits on mortgage loans	**76,643**	67,325
Other deposits	**3,680,355**	3,488,132
Payable for acquisition of investments	**31,629,610**	6,055,833
Total liabilities	**39,219,894**	13,269,324
Net assets held in trust for pension benefits	**$ 1,002,117,490**	$ 869,349,262

See accompanying notes.

University of Puerto Rico Retirement System

Statements of Changes in Plan Net Assets

	June 30	
	2007	**2006**
Additions:		
Contributions:		
Employer	**$ 78,310,774**	$ 73,658,083
Employees	**40,029,937**	38,709,632
	118,340,711	112,367,715
Investment (loss) income:		
Net appreciation (depreciation) in fair value of investments	**104,569,678**	36,058,907
Interest	**21,406,687**	20,477,149
Dividends	**5,272,213**	4,590,121
	131,248,578	61,126,177
Less investments expenses	**2,546,568**	2,021,249
	128,702,010	59,104,928
Medical insurance reimbursements from the University of Puerto Rico	**8,196,843**	7,759,401
Total additions	**255,239,564**	179,232,044
Deductions:		
Benefits paid to participants	**110,831,424**	105,089,895
General and Administrative expenses	**3,443,069**	3,262,651
Medical insurance expenses paid to retirees	**8,196,843**	7,759,401
Total deductions	**122,471,336**	116,111,947
Net increase in net assets held in trust for pension benefits	**132,768,228**	63,120,097
Net assets held in trust for pensions benefits:		
Beginning of year	**869,349,262**	806,229,165
End of year	**$ 1,002,117,490**	$ 869,349,262

See accompanying notes.

1. Organization and Summary of Significant Accounting Policies

Organization

The University of Puerto Rico Retirement System (the System) is the administrator of a single-employer defined benefit pension plan that was created by Act No. 135, approved on May 7, 1942. The System started operations on January 1, 1945, the date on which contributions by employees and the University of Puerto Rico (the University) (a related party) commenced.

The responsibility for the proper operation and administration of the System is vested in a Board of Trustees, composed of certain members of the University's Board of Trustees. The following are the significant accounting policies followed by the System in the preparation of its financial statements.

Basis of Presentation

The System's financial statements and notes to the financial statements are prepared under the provisions of Governmental Accounting Standards Board (GASB) Statement No. 25 (GASB No. 25), *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*.

The System implemented during this fiscal year ended June 30, 2006 the GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment of GASB Statement No. 3*. this statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest-rate risk, and foreign currency risk. As an element of interest-rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement also should be disclosed (Note 4).

The accompanying financial statements have been prepared on the accrual basis of accounting. Employee and employer contributions are recognized in the period in which the contributions are due and the employer has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with the terms of the plan.

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

Use of Estimates

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

Cash Equivalents

The Plan considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Investments

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Marketable securities are valued based on quotations obtained from national security exchanges. Dividend income is recognized when received.

The market value of investments held in foreign currencies are translated into U.S. dollars generally using current rates of exchange and the related translation adjustments in addition to the unrealized (depreciation) appreciation in fair value of investments which is recorded in the statement of changes in plan net assets as unrealized (depreciation) appreciation in fair value of the investments.

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

Loans to Plan Members

Loans to participants are carried at their unpaid principal balance, which approximates their fair value. Mortgage loans are collateralized by the participant's contribution to the pension plan and first mortgage liens on the underlying properties.

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

The System's Board of Trustees granted certain participants the option to select a supplemental pension benefit by making a retroactive contribution to the System. The participants who accept this option have to make a lump-sum payment to cover the related benefits. The participants could obtain an interest-bearing loan from the System to fund their contributions. As of June 30, 2007 and 2006, the balance of other loans consisted of the principal balance of such contributions, which amounted to approximately $18,144,997 and $18,273,248, respectively.

Property and Equipment

Property and equipment is recorded at cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the depreciable property.

Expenditures for maintenance and repairs are charged to operations, while those for renewals and betterments are capitalized. Depreciation expense charged to operations during the years ended June 30, 2007 and 2006 amounted to approximately $52,000 and $42,000, respectively.

2. Description of the System

General

The System is a single-employer defined benefit pension plan that covers all employees of the University with the exception of hourly, temporary, part-time, contract and substitute employees, and visiting professors. It is qualified and exempt from Puerto Rico and United States taxes.

Membership consisted of the following as of June 30, 2007 and 2006:

	2007	**2006**
Retirees and beneficiaries receiving benefits	**$ 6,656**	$ 6,508
Terminated plan members entitled to but not yet receiving benefits	**369**	366
Terminated non-vested plan members entitled to return of their contributions	**7,188**	7,188
Active plan members	**12,550**	12,590
Total	**$26,763**	$26,652

2. Description of the System (continued)

Plan Amendments

Effective July 1, 2004, the Plan was amended by establishing Certification 130, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 2001, with a monthly minimum of $10.

Effective July 1, 2002, the Plan was amended, by establishing Certification 139, to offer participants an increase from $50,000 to $60,000 in the maximum salary subject to withholding contribution. The participants who elect this benefit may pay retroactively to their first day of employment the differences in withholding contributions for prior year salaries exceeding $50,000 and up to a maximum of $60,000 plus 8% interest. Also, effective July 1, 2002, maximum salary basis will increase automatically 3% every two years.

Effective July 1, 2001, the Plan was amended by establishing Certification 140, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1998, with a monthly minimum of $10.

Effective July 1, 1999, the Plan was amended by establishing Certification 128, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1995, with a monthly minimum of $10.

Effective July 1, 1998, the Plan was amended by establishing Certification 94, to offer participants an increase from $35,000 to $50,000 in the maximum salary subject to withholding contributions. The participants who elect this benefit may pay retroactively to their first day of employment the differences in withholding contributions for prior year salaries exceeding $35,000 and up to a maximum of $50,000 plus 8% interest. Effective July 1, 1998, all new participants contribute 9% of their salary up to $50,000.

Effective July 1, 1995, the Plan was amended by establishing Certification 194, to increase by 3% the pension benefits to those employees who retired due to age or disability and who have been retired for at least three years as of January 1, 1992, with a monthly minimum of $10.

2. Description of the System (continued)

Plan Amendments (continued)

In addition, the maximum annual compensation for those participants who had not completed 20 years of service by July 1, 1979 is $35,000. Also, the minimum pension is $250 a month. Finally, the reduction for commencement of pension benefits prior to age 65 is 1/3% per month for participants who had not completed 20 years of service by July 1, 1979 and elected Certification 55, and for participants hired on or after January 1, 1990.

Contributions and Funding Policy

The contribution requirements of plan members and the University are established and may be amended by the Board of Trustees. Plan members are required to contribute as follows:

<u>Members who elect Certification No. 139:</u> 11% of monthly compensation up to $5,000

<u>Members who have not completed 20 years of service by July 1, 1979:</u>

- If full supplement is elected: 7% of monthly compensation up to $2,625
- If full supplement is not elected: 5% of monthly compensation up to $2,625
- If Certification 94 is elected: 9% of monthly compensation up to $4,500

<u>Members who have completed 20 years of service by July 1, 1979:</u>

- If full supplement is elected: 7% of monthly compensation
- If full supplement is not elected: 4% of monthly compensation up to $350, plus 6.5% of the excess

<u>Members who have not completed 20 years of service by July 1, 1979 and elect Certification 55:</u>

- If full supplement is elected: 7% of monthly compensation up to $2,625
- If full supplement is not elected: 4% of monthly compensation up to $350, plus 6.5% of the excess up to $2,625
- If Certification 94 is elected: 9% of monthly compensation up to $4,167

2. Description of the System (continued)

Contributions and Funding Policy (continued)

<u>Members who are hired between January 1, 1990 and June 30, 1998:</u>

- 8% of monthly compensation up to $2,625 or,
- If Certification 94 is elected: 9% of monthly compensation up to $4,167

<u>Members who are hired on or after July 1, 1998:</u>

- 9% of monthly compensation up to $4,167

The University is supposed to contribute at an actuarially determined rate; the rate as of June 30, 2007 and 2006 was 11.1% and 11.3%, respectively, of annual covered payroll. The actuarially determined employer contribution rate takes into account payment of administrative expenses.

Therefore, administrative expenses are paid out of the trust fund. The University contributed 15% of participants' payroll in both 2007 and 2006.

The contributions of the University were originally designed to fund, together with the contributions of the members, the current service cost on a current basis and the estimated accrued benefit cost attributable to qualifying service prior to the establishment of the System over a forty-year period, but as a result of increasing benefits without a correlative increase in employer's contributions, they fall short of accomplishing the necessary funding.

Retirement Benefits

The System provides retirement, disability and death benefits to plan members and beneficiaries. Cost-of-living adjustments are provided to members and beneficiaries at the discretion of the Board of Trustees of the University, formerly known as the Council on Higher Education of the University of Puerto Rico. Article XIII of the Rules and Regulations of the System as amended effective July 1, 1973, assigns the authority to establish and amend benefit provisions to the Board of Trustees.

2. Description of the System (continued)

Retirement Benefits (continued)

Participants who have completed 20 years of service by July 1, 1979 are entitled to annual retirement benefits at any age after 30 years of service. Otherwise, participants are entitled to annual retirement benefits at age 55 after 30 years of service. Participants may elect to receive their retirement benefits at age 58 after 10 years of service, or at age 55 after 25 years of service.

The amount of service retirement annuity is as follows:

- For all members except those who have completed 20 years of service by July 1, 1979:
    - Before age 65 - for members with at least 30 years of service: 75% of average compensation. Amount is reduced by .5% for each month the member is under age 58 (Certification 37) and 55 (Certification 55), at time annuity begins.
    - Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for the member with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% per year. Amount is reduced by .5% for each month the member is under age 58 at time annuity begins.
    - After age 65 - if the member elected full supplement, the annuity is the same as before age 65. Otherwise, the annuity is reduced by .5% of average compensation not in excess of Social Security wage base in effect at retirement for each year of service. If the member had less than 30 years of service and was under age 58 at the beginning date, adjustment is made before application of .5% reduction per month under age 58.
- For those members who have completed 20 years of service by July 1, 1979:
    - Before age 65 - for members with at least 30 years of service: 75% of average compensation if age 55 at beginning date; 65% if under age 55. If the member completed 30 years of service before July 1973, the annuity is increased by 2% of average compensation for each year of service beyond 30 and before July 1973, but to not more than 85% of average compensation.

2. Description of the System (continued)

Retirement Benefits (continued)

- Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for members with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to maximum of 1.95% per year. Amount is reduced by .5% for each month the member is under age 58 at the time the annuity begins.

- At age 65 - if member elected full supplement, the annuity is the same as before age 65. Otherwise, the annuity is reduced by .5% of first $350 of average compensation for each year of service but not by more than primary Social Security benefit. If the member had less than 30 years of service and was under age 58 at beginning date, adjustment is made before application of .5% reduction per month under age 58.

• For all members who have not completed 20 years of service by July 1, 1979 and elect Certification 55, and for those hired on or after January 1, 1990:

  - Before age 65 - for members with less than 30 years of service: 1.5% of average compensation per year of service for members with 20 or fewer years. Percentage increases by .05% for each year in excess of 20 years up to a maximum of 1.95% per year.

  - Before age 65 - for members with at least 30 years of service: 75% of average compensation for participants with at least 55 years of age at retirement date. Amount reduced by .5% for each month the member is under age 55 at time annuity begins.

  - Age 65 - if member elected full supplement, annuity is the same as before age 65. Otherwise, annuity is reduced by .5% of average compensation at time of retirement multiplied by years of service.

  - Minimum Annuity - $250 per month - if a member terminates before rendering 10 years of service, the right to receive the portion of his accumulated plan benefits attributable to the University's contributions is forfeited. However, the employee is entitled to receive, in a lump-sum payment, the value of his accumulated contributions.

2. Description of the System (continued)

Retirement Benefits (continued)

- If a member terminates after rendering 10 years of service, and does not withdraw his contributions, the member receives a retirement annuity payable beginning at age 60 based on the applicable benefit formula.

- Refund may also be obtained after 10 years of service, but the vested benefit is lost.

Disability Benefits

- Employees who become disabled receive annual disability benefits regardless of service if disability is due to occupational causes or after 10 years of service if disability is due to non-occupational causes. If the employee is also eligible for a retirement annuity, the benefit payable is the higher of the two. Disability benefits are paid as follows:

  - Before age 65 - if service related, 50% of final salary. If not service related, 30% of average compensation plus additional 1% for each year of service over 10.

  - After age 65 - reduced to amount payable as retirement annuity, if that amount is less than disability retirement annuity, but reduced annuity plus primary Social Security benefit may not be less than original disability annuity.

Death Benefits

- Pre-retirement death benefit - if the death of an employee is service related, a death benefit equal to 50% of the final annual salary plus $120 ($240 if widow not receiving benefit) per year for each child under age 18 (21 if at school) is paid to the employee's beneficiaries. Maximum family benefit is 75% of the employee's final annual salary. If death is non-service related, a lump-sum is paid equal to the employee's contributions plus one year's final salary, but not less than $6,000.

2. Description of the System (continued)

Death Benefits (continued)

- Post retirement death benefits - employee's contributions are refunded to the extent that they exceed retirement payments already made, unless reversionary annuity was elected. Minimum payment is $600. In addition, 50% of retirement annuity is payable to surviving spouse until death or remarriage or until they become eligible for Social Security benefits. Minimum annuity, $75 per month, maximum annuity, $150 per month.

Christmas Bonus

- A $400 annual bonus is given to all retiree plan members.

3. Cash, Cash Equivalents and Short-Term Investments

Cash, cash equivalents and short-term investments as of June 30, 2007 and 2006 are as follows:

	2007	2006
Cash and cash equivalents	**$18,453,428**	$21,830,579
Temporary investments	**17,161,330**	13,595,614
	$35,614,758	$35,426,193

The cash balance of $18.4 million as of June 30, 2007, is insured by the Federal Deposit Insurance Corporation or collateralized with securities held on behalf of the System by the Secretary of the Treasury of the Commonwealth of Puerto Rico, or the Secretary's agent in the name of the Secretary.

Pursuant to present statutes, deposits of financial institutions, other than with Government Development Bank of Puerto Rico (GDB), shall be in banks designated by the Puerto Rico Secretary of the Treasury as depository institutions of public funds. Such deposits are guaranteed by sufficient collateral under the name and custody of the Puerto Rico Secretary of the Treasury.

4. Investments

The following table presents the fair value of investments on marketable securities as of June 30, 2007 and 2006:

	2007	**2006**
Marketable securities:		
U.S. Government obligations	**$ 33,691,083**	$ 31,476,128
U.S. Government agencies' obligations	**22,420,873**	7,475,980
Sovereign bonds	**595,420**	–
Foreign bonds	**8,190,670**	1,144,295
Corporate bonds and other debentures	**101,654,406**	39,784,698
Foreign common tock	**110,647,503**	79,022,514
Common stock	**255,115,821**	214,742,843
Mortgage-backed securities	**98,534,578**	23,730,957
Foreign securities certificates	**1,591,908**	–
Mutual funds	**222,627,664**	184,045,468
Treasury bills	**–**	128,938,346
Other investments	**471,427**	785,917
Total	**$855,541,353**	$711,147,146

No more than 5% of any debt issue may be purchased as an investment, with the exception of the U.S. government or its agencies. No more than 10% of the assets at cost may be invested in the securities of a single issuer, with the exception of the U.S. government or its agencies.

The custody of these investments is held by the trust department of a commercial bank in the name of the System and the portfolio is managed by ten brokerage firms.

The System's Regulations authorize the System to invest a percentage of total assets, with certain limitations, in the following types of investments; not less than 23% and no more than 33% in Fixed Income Securities, not less than 7% and no more than 13% in equity securities. On international equity and private equity no more than 7% and 13%, respectively, and on non-U.S. fixed income securities up to15%.

4. Investments (continued)

The investments in bonds must be classified, at the time of purchase, within the highest three classifications designated by one of the principal agencies that classifies securities and the bond portfolio average due date must be seven years.

The investments in bonds collateralized by mortgages must be a first mortgage on properties within the United States.

Common stock must only be purchased when they are classified within the first four categories of Standard and Poor's and the first three of Value Line. The System's cash reserve should be invested in high quality short-term investments including negotiable instruments, U.S. Treasury obligations, certificates of deposit, bank acceptances and repurchase agreements. Cash under the custody of the Secretary of the Treasury amounting to $68,613 as of June 30, 2007 and 2006 is deposited with the GDB and is uncollateralized.

In addition, the System invests in limited partnerships (Private Equity Funds). These limited partnerships invest in United States and international private equity investment partnerships, which in turn, invest in equity and equity related investments.

Private equity funds include the following at June 30, 2007 and 2006:

	Total Commitment	Contributions at June 30, 2007	Fair Value
Grupo Guayacán, Inc.:			
Guayacán Fund of Funds I, LP	$ 5,000,000	$ 4,700695	$ 1,747,076
Guayacán Fund of Funds II, LP	6,000,000	5,618,752	4,046,137
Advent-Morro Equity Partners Inc.:			
Guayacán Private Equity Fund I, LP	2,500,000	2,203,393	2,576,493
Guayacán Private Equity Fund II, LP	5,000,000	400,000	400,000
DCC Growth Fund, LP	2,000,000	1,875,560	2,202,445
Total	$20,500,000	$14,798,400	$10,972,151

4. Investments (continued)

	Total Commitment	Contributions at June 30, 2006	Fair Value
Grupo Guayacán, Inc.:			
Guayacán Fund of Funds, LP	$ 5,000,000	$ 4,655,820	$ 1,849,125
Guayacán Fund of Funds II, LP	6,000,000	4,713,472	4,059,883
Advent-Morro Equity Partners Inc.:			
Guayacán Private Equity Fund, LP	2,500,000	2,203,393	2,617,367
DCC Growth Fund, LP	2,000,000	1,875,560	2,069,806
	$15,500,000	$13,448,245	$10,596,181

Credit Risk

Issuer credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Investments issued or explicitly guaranteed by the United States government are excluded. The System's policy requires and limits investments in debt securities to only those in the top investment grade ratings issued by a nationally recognized statistical rating organization. As of June 30, 2007, the System's credit quality distribution for securities was as follows:

	Carrying	Standard &
Foreign bonds	$ 8,190,670	A+ to A
Corporate bonds and other debentures	$101,654,406	AAA to BBB-

Custodial Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The System's cash, cash equivalents and short-term investments are not exposed to custodial credit since cash balances of the System are insured by the Federal Deposit Insurance Corporation or collateralized with securities held on behalf of the System by the Puerto Rico Secretary of Treasury or the Secretary's agent in the name of the Secretary. Pursuant to present statutes, deposits of financial

4. Investments (continued)

Custodial Risk (continued)

institutions, other than with GDB, shall be in banks designated by the Puerto Rico Secretary of the Treasury as depository institutions of public funds. Such deposits are guaranteed by sufficient collateral under the name and custody of the Puerto Rico Secretary of the Treasury. Investments of the System, which are under custody of a depository institution, are as follows:

Security Type	Carrying Value
Mortgage baked securities	$ 98,534,578
Corporate bonds and other debentures	101,654,406
Common Stocks	255,115,821
Government bonds	22,420,873
Treasury bills	33,691,083
Foreign equities	110,647,503
Foreign corporate bonds	3,577,852
Foreign government bonds	4,612,818
Other investments	2,676,229

The System has a Security Lending Agreement (the Agreement) with its investment custodian (the Custodian). In this Agreement, the University agrees to lend certain securities upon request of a borrower. The Custodian is the managing agent in this agreement where upon request of a borrower, the Custodian lends, as mentioned before, securities in exchange of collateral. Collateral may consist of cash, other approved securities and/or letter of credit from the borrower. The Custodian has unrestricted right to invest any cash collateral; also, the Custodian may commingle any approved securities held as collateral with any other securities held under custody on behalf of the University. Under the Agreement, the borrower is compelled to return the securities lend by the University upon termination of the loan term.

Under the securities lending agreement (the Agreement) as disclosed above, the System received in cash collateral approximately $104 million. This cash collateral has been reinvested, in accordance with the Agreement, in fixed income investments that are exposed to custodial credit risk as disclosed above.

4. Investments (continued)

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer. Information regarding investment in any one issuer that represents five percent or more of the System's total investments must be disclosed under GASB No. 40, excluding investments issued or explicitly guaranteed by the United States government. The System's portfolio is not exposed to concentration of credit risk since the investment policies does not allow to invest in any single issuer more than 5% of the total portfolio, except for Government securities.

Interest-Rate Risk

Interest-rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value is to changes in market interest rates. As of June 30, 2007, the weighted average maturity by investment type in each fund follows:

Investment Type	Maturities	Amount
Corporate Bonds	January 2008 - December 2012	$ 45,079,143
Corporate Bonds	January 2013 - July 2017	10,532,912
Corporate Bonds	February 2018 - June 2028	1,682,879
Corporate Bonds	August 2029 - November 2033	14,813,298
Corporate Bonds	March 2034 - August 2038	19,625,163
Corporate Bonds	July 2039 - July 2097	13,350,156
FHLMC	March 2014 - December 2017	783,626
FHLMC	January 2018 - July 2022	19,974,681
FHLMC	February 2029 - August 2032	4,137,630
FHLMC	November 2034 - June 2037	15,349,415
FNMA	June 2011 - December 2017	4,008,242

4. Investments (continued)

Interest-Rate Risk (continued)

Investment Type	Maturities	Amount
FNMA	February 2018 - June 2033	8,899,690
FNMA	February 2035 - May 2037	44,006,876
GNMA	January 2008 - December 2029	2,323,318
GNMA	March 2036 - May 2036	3,145,950
Government Bonds	January 2008 - March 2012	22,407,793
Government Bonds	March 2013 - December 2017	11,869,743
Government Bonds	December 2018 - October 2025	11,238,616
Government Bonds	May 2030	5,406,248
Government Bonds	February 2036 - February 2037	6,451,650
Municipal Bonds	February 24 - June 33	488,900
		$ 265,575,929

Foreign Currency Risk

A System's exposure to foreign currency risk derives from its positions in foreign currency denominated equities and fix income investments. The System's investment policy permits it to invest up to 15% of total investments in foreign currency denominated investments. The System's investments in foreign currency denominated corporate bonds were rated AAA by Standard & Poor's Investors Service. The system's exposure to foreign currency risk is as follows:

Security Type	Currency	Maturity	Carrying Value
Common Stocks	Australian Dollar	Not Applicable	$ 4,437,619
Common Stocks	Austrian Schilling	Not Applicable	1,672,413
Common Stocks	Belgian Franc	Not Applicable	600,037
Common Stocks	Bermuda Dollar	Not Applicable	2,426,968
Common Stocks	Brazil Real	Not Applicable	2,414,698
Common Stocks	Canadian Dollar	Not Applicable	5,629,627
Corporate Bonds	Canadian Dollar	05/2012 to 10/2013	235,265

4. Investments (continued)

Foreign Currency Risk (continued)

Security Type	Currency	Maturity	Carrying Value
Governmental Bonds	Canadian Dollar	11/5/2008	528,101
Corporate Bonds	Chilean Peso	7/9/2013	75,439
Governmental Bonds	Chilean Peso	11/15/2013	92,079
Common Stocks	China Yuan	Not Applicable	299,710
Governmental Bonds	China Yuan	11/15/2008	135,582
Common Stocks	Danish Krone	Not Applicable	1,056,487
Common Stocks	Finland Markkaa	Not Applicable	609,954
Common Stocks	France Francs	Not Applicable	9,853,740
Common Stocks	Germany Marks	Not Applicable	8,395,146
Corporate Bonds	Germany Marks	12/2009 to 7/2015	844,466
Common Stocks	Cayman Island Dollar	Not Applicable	4,169,063
Corporate Bonds	Cayman Island Dollar	4/1/2031	110,581
Common Stocks	Euro	Not Applicable	737,852
Common Stocks	Hong Kong Dollar	Not Applicable	1,227,747
Common Stocks	Hungarian Forint	Not Applicable	106,575
Common Stocks	Indian Rupee	Not Applicable	1,578,018
Common Stocks	Irish Punt	Not Applicable	711,767
Common Stocks	Israeli New Shekel	Not Applicable	801,323
Common Stocks	Italy Lire	Not Applicable	3,523,213
Governmental Bonds	Italy Lire	6/2008 to 6/2033	844,286
Common Stocks	Japan Yen	Not Applicable	18,448,476
Common Stocks	Korean Won	Not Applicable	1,234,580
Governmental Bonds	Korean Won	7/2009 to 3/2015	524,865
Common Stocks	Luxembourg Franc	Not Applicable	1,081,352
Corporate Bonds	Luxembourg Franc	11/2013 to 9/2034	547,359
Common Stocks	Mexico Peso	Not Applicable	600,486
Common Stocks	Netherlands Guilders	Not Applicable	4,488,654
Corporate Bonds	Netherlands Guilders	7/2008	208,472

4. Investments (continued)

Foreign Currency Risk (continued)

Security Type	Currency	Maturity	Carrying Value
Common Stocks	Norwegian Kroner	Not Applicable	887,858
Common Stocks	Panama Balboa	Not Applicable	24,385
Governmental Bonds	Polish Sloty	10/15/2015	55,457
Common Stocks	Singapore Dollar	Not Applicable	1,025,204
Common Stocks	South Afriacan Rand	Not Applicable	196,403
Common Stocks	Spanish Peseta	Not Applicable	3,320,728
Corporate Bonds	Spanish Peseta	11/2009	416,084
Governmental Bonds	US Dollar	2/2010 to 10/2025	2,432,447
Common Stocks	Sweden Kronan	Not Applicable	933,471
Common Stocks	Switzerland Francs	Not Applicable	7,095,481
Common Stocks	Taiwan Dollar	Not Applicable	630,860
Common Stocks	Tai Bath	Not Applicable	164,229
Common Stocks	United Kingdom Pounds	Not Applicable	20,263,381
Corporate Bonds	United Kingdom Pounds	2/2010-12/2049	1,140,185
			$118,838,173

Derivatives

In order to protect against the potential change in interest rates and to keep the temporary available funds fully invest in equities, the University of Puerto Rico Retirement System entered into various US bond and stocks index derivatives.

The terms, fair values of the outstanding US bond index derivatives were as follow:

Position Description	Notional Amount	Effective Date	Maturity Date	Fair Value
US 5Yr Note Sep 07	$(8,093,832)	July 3, 2009	September 28, 2007	$(8,118,094)
US 2Yr Note Sep 07	(3,045,240)	July 3, 2006	September 28, 2007	(3,056,718)
US 10Yr Note Sep 07	625,534	June 22, 2007	September 19, 2007	634,219
US Long Bond Sep 07	8,137,665	June 22, 2006	September 19, 2007	8,081,250
DJ Euro Stoxx 50	664,380	June 12, 2007	September 21, 2007	677,250
Total	$(1,711,493)			$(1,782,093)

As of June 30, 2007, the derivatives had a negative fair value of $2.45 million. The positive fair value of the derivatives may be countered by the decreased in the fair value of the notes in order to maintain the sensitivity of bond's price to interest rate movements and yield maintenance.

As of June 30, 2007, the stock derivatives has a positive fair value of $677,250 used to fully invest in equities temporary funds

5. Capital Assets

Property and equipment additions are recorded at cost. Depreciation is provided using the straight-line method over the useful life of the asset. For the years ended June 2007 and 2006, changes in property and equipment, consisted of the following:

	Beginning Balance at June 30, 2006	Additions	Retirements	Ending Balance at June 30, 2007
Building	$1,440,000	$ –	$ –	**$1,440,000**
Equipment	381,087	21,397	–	**402,484**
	1,821,087	21,397	–	**1,842,484**
Less accumulated depreciation	(465,836)	(51,657)	–	**(517,493)**
	$1,355,251	$ (30,260)	$ –	**$1,324,991**

5. Capital Assets

	Beginning Balance at June 30, 2005	Additions	Retirements	Ending Balance at June 30, 2006
Building	$ 140,000	$1,300,000	$ –	$1,440,000
Equipment	361,302	19,785	–	381,087
	501,302	$1,319,785	–	1,821,087
Less accumulated depreciation	(424,190)	(41,646)	–	(465,836)
	$ 77,112	$1,278,139	$ –	$1,355,251

6. Other Assets

Other assets consist of properties obtained upon mortgage foreclosure proceedings as collateral from delinquent mortgage loans. For the years ended June 30, 2007 and 2006, these properties amounted to $80,100 and $113,200, respectively. Foreclosed properties are valued at appraised values by third parties. These properties will be sold under a bidding process intended to recover the outstanding principal balance. 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, are not material. Management believes that the carrying value of these properties approximates their fair value.

7. Medical Insurance

The System pays to each retiree up to a maximum of $125 monthly for medical plan expenses. For the years ended June 30, 2007 and 2006, medical plan expenses amounted to approximately $8,196,843 and $7,759,401, respectively. In 2007 and 2006, the University reimbursed the System for the payments made.

8. Related Party Transactions

All contributions of the System are received from the University. In addition, the University reimburses the System certain medical insurance expenses (see to Note 7).

ERNST & YOUNG

Ernst & Young LLP
1000 Scotiabank Plaza
273 Ponce de Leon Avenue
Hato Rey, Puerto Rico 00917-1951

Phone: (787) 759-8212
Fax: (787) 753-0808
Fax: (787) 753-0813
www.ey.com

Report on Independent Auditors on Compliance and Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
of the University of Puerto Rico Retirement Systems

We have audited the financial statements of plan assets of the University of Puerto Rico Retirement System (the System) as of and for the year ended June 30, 2007 and 2006, and have issued our report thereon dated March 10, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, trustees and management and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

March 10, 2008

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affixed to
the original
of this report.

Required Supplementary Information
(Unaudited)

University of Puerto Rico Retirement System

Schedule of Employer Contributions

June 30, 2007

Year Ended June 30	Required Contribution as a Percentage of Payroll for Year Ended (1)	Actual Payroll	Annual Required Contribution (ARC)	Employer Contribution Made	Percentage Contributed	(Excess) / Deficiency
2007	11.1%	$ 518,236,607	$ 57,524,263	$ 78,310,774	136.1%	$ (20,786,511)
2006	11.3%	490,262,657	55,399,680	73,658,083	133.0%	(18,258,403)
2005	18.4%	460,174,370	84,672,084	69,291,395	81.8%	15,380,689
2004	16.2%	433,607,194	70,244,365	61,376,007	87.4%	8,868,358
2003	16.1%	407,357,391	65,584,540	57,551,270	87.8%	8,033,270
2002	14.0%	387,508,328	54,251,166	52,326,004	96.5%	1,925,162
2001	11.0%	376,992,691	41,469,196	54,040,933	130.3%	(12,571,737)
2000	12.6%	348,397,129	43,898,038	49,651,679	113.1%	(5,753,641)
1999	11.7%	330,179,269	38,630,974	53,041,795	137.3%	(14,410,821)
1998	12.3%	327,884,351	40,329,775	48,856,041	121.1%	(8,526,266)
1997	14.0%	311,025,104	43,543,515	46,600,524	107.0%	(3,057,009)
1996	14.6%	280,144,023	40,901,027	41,516,818	101.5%	(615,791)
1995	14.8%	261,613,882	38,718,855	36,479,385	94.2%	2,239,470
1994	14.8%	245,096,878	36,274,338	34,145,484	94.1%	2,128,854
1993	14.3%	232,505,968	33,248,353	32,399,088	97.4%	849,265
1992	14.3%	231,818,990	33,150,116	29,581,402	89.2%	3,568,714
1991	14.3%	213,752,919	30,566,667	25,828,085	84.5%	4,738,582

(1) ARC Rate for each fiscal year comes from actuarial valuation at start of that fiscal year (e.g., the June 30, 2006 Required Contribution was established in the June 30, 2004 actuarial valuation).

See notes to schedules of trend information.

University of Puerto Rico Retirement System

Schedule of Funding Progress

June 30, 2007

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability - Entry Age (AAL) (b)	Unfunded AAL (not <0) (UAAL) (b) - (a)	Funded Ratio (a) - (b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b) - (a)]/(c)
6/30/2007	$ 953,197,000	$ 2,068,102,695	$ 1,114,905,695	46.0%	$ 513,486,180	217.1%
6/30/2006	869,211,000	1,930,131,983	1,060,920,983	45.0%	484,886,628	218.8%
6/30/2005	820,501,000	1,848,175,710	1,027,674,710	44.4%	460,956,060	222.9%
6/30/2004	803,498,000	1,748,529,453	945,031,453	46.0%	431,942,112	218.8%
6/30/2003	778,265,000	1,594,436,193	816,171,193	48.8%	405,855,271	201.1%
6/30/2002	640,406,669	1,546,249,360	905,842,691	41.4%	390,192,418	232.2%
6/30/2001	686,067,220	1,311,021,235	624,954,015	52.3%	363,995,029	171.7%
6/30/2000	753,863,676	1,212,559,037	458,695,361	62.2%	341,871,667	134.2%
6/30/1999	650,294,843	1,161,100,932	510,806,089	56.0%	333,153,432	153.3%
6/30/1998	586,095,318	1,037,281,510	451,186,192	56.5%	322,232,048	140.0%
6/30/1997	505,466,931	957,716,124	452,249,193	52.8%	305,498,420	148.0%
6/30/1996	427,435,099	912,242,254	484,807,155	46.9%	283,798,140	170.8%
6/30/1995	382,934,691	856,494,515	473,559,824	44.7%	261,466,451	181.1%
6/30/1994	N/A	N/A	N/A	N/A	N/A	N/A
6/30/1993	343,302,357	748,243,399	404,941,042	45.9%	221,986,837	182.4%
6/30/1992	N/A	N/A	N/A	N/A	N/A	N/A
6/30/1991	280,341,508	646,980,619	366,639,111	43.3%	209,377,144	175.1%

See notes to schedules of trend information.

University of Puerto Rico Retirement System

Notes to Schedules of Trend Information

June 30, 2007

1. Schedule of Funding Progress

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

2. Schedule of Employer Contributions

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

3. Actuarial Data

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

Valuation Date	June 30, 2007
Actuarial Cost Method	Entry age normal - traditional
Amortization Method	Level percentage of payroll method with basis on open amortization period of 30 years starting June 30, 1995
Remaining Amortization Period	30 years
Asset Valuation Method	The actuarial value of assets is determined by adjusting the market value of assets to reflect investment gains and losses (the difference between the actual investment return and the expected investment return) during each of the last five years at the rate of 20.00% per year. Expected investment return is calculated from the prior market value of assets, including receivable contributions, and weighted expected transactions. The actuarial value of the assets as of June 30, 2007 was $953,197,000.

3. Actuarial Data (continued)

Actuarial Assumptions:

Investment rate of return	8%, net of investment expenses
Projected salary increases	5% per annum

University of Puerto Rico Retirement System

Three-Year Pension Cost Trend Information

June 30, 2007

Fiscal Year Ending	Annual Pension Cost (APC)	Employer Contribution	Percentage of APC Contributed	Net Pension Obligation (NPO)
6/30/2007	$ 57,737,197	$ 78,310,774	135.6%	$ (13,772,652)
6/30/2006	56,160,455	73,658,083	131.2%	6,800,925
6/30/2005	84,657,964	69,291,395	81.8%	24,298,553
6/30/2004	70,244,303	61,376,007	87.4%	8,931,984
6/30/2003	65,584,540	57,551,270	87.8%	63,688

Additional Information

Valuation date: 6/30/2007
Actuarial cost method: Entry Age Normal (traditional)
Level percentage of payroll method with basis on open amortization period of 30 years starting June 30, 1995

Remaining amortization period 30 years (closed basis)
Market value adjusted to reflect investment gains and losses over a five (5) year period. See tables VIII and X for a more detailed explanation of Actuarial Value of Assets methodology.

Actuarial assumptions:

Investment rate of return*	8.00%
Projected salary increases*	5.00%
Post retirement benefit increases	Other that the automatic increase of 3.00% every two (2) years applicable to salary cap of Certification 139, NO postretirement benefit increases are assumed.
Mortality Table	1994 Group Annuity Mortality

**Includes inflation at 3.50%.*