NEW ISSUE - BOOK-ENTRY ONLY
See "Book-Entry Only System" under The Bonds

In the opinion of Bond Counsel, under the provisions of the Acts of Congress now in force, (i) subject to continuing compliance with certain tax covenants, interest on the Bonds will not be includable in gross income for federal income tax purposes, and (ii) the Bonds and interest thereon will be exempt from state, Commonwealth and local income taxation under existing law. However, see "Tax Matters" for a description of alternative minimum tax consequences with respect to interest on the Bonds and other tax considerations.

$250,000,000
COMMONWEALTH OF PUERTO RICO
Public Improvement Bonds of 2008, Series A
(General Obligation Bonds)

Dated: Date of Delivery **Due: July 1, as shown below**

The Bonds are issuable as registered bonds without coupons and will be initially registered only in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Bonds. Bonds will be available to purchasers in denominations of $5,000 and whole multiples thereof only under the book-entry system maintained by DTC through brokers and dealers who are, or act through, DTC Participants. **Purchasers will not receive delivery of the Bonds. So long as any purchaser is the beneficial owner of a Bond, he must maintain an account with a broker or dealer who is, or acts through, a DTC Participant to receive payment of principal and interest on such Bond.** See "Book-Entry Only System" under *The Bonds*. Interest on the Bonds will accrue from their date of issuance at the annual rates described below, and will be payable semi-annually on each January 1 and July 1, commencing on January 1, 2009. The Bonds are subject to redemption prior to maturity as set forth herein.

THE BONDS ARE GENERAL OBLIGATIONS OF THE COMMONWEALTH. THE GOOD FAITH, CREDIT AND TAXING POWER OF THE COMMONWEALTH ARE IRREVOCABLY PLEDGED FOR THE PROMPT PAYMENT OF THE PRINCIPAL OF AND INTEREST ON THE BONDS. THE CONSTITUTION OF PUERTO RICO PROVIDES THAT PUBLIC DEBT OF THE COMMONWEALTH, WHICH INCLUDES THE BONDS, CONSTITUTES A FIRST CLAIM ON AVAILABLE COMMONWEALTH RESOURCES.

Maturity July 1,	Amount	Interest Rate	Yield	CUSIP
2010	$3,850,000	5.00%	3.40%	74514LVA2
2011	4,040,000	5.00	3.72	74514LVB0
2012	4,245,000	5.00	3.93	74514LVC8
2013	4,455,000	5.50	4.12	74514LVD6
2014	4,700,000	5.50	4.31	74514LVE4
2015	4,960,000	5.50	4.47	74514LVF1
2016	5,230,000	5.50	4.62	74514LVG9
2017	5,520,000	5.50	4.78	74514LVH7
2018	5,825,000	5.50	4.93	74514LVJ3

$33,950,000, 5.000% Term Bond due July 1, 2023, Yield: 5.160% CUSIP: 74514LVK0
$43,435,000, 5.125% Term Bond due July 1, 2028, Yield: 5.310% CUSIP: 74514LVL8
$56,055,000, 5.375% Term Bond due July 1, 2033, Yield: 5.480% CUSIP: 74514LVM6
$73,735,000, 6.000% Term Bond due July 1, 2038, Yield: 5.490% CUSIP: 74514LVN4

The Bonds are offered for delivery when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Sidley Austin LLP, New York, New York, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by Squire, Sanders & Dempsey L.L.P., Miami, Florida. It is expected that the Bonds will be available for delivery through the facilities of DTC on or about September 18, 2008.

Morgan Stanley **Banc of America Securities LLC** **UBS Financial Services Puerto Rico**

BBVAPR MSD **Citi** **DEPFA First Albany Securities LLC**

Eurobank MSD **Goldman, Sachs & Co.** **JPMorgan**

Lehman Brothers **Loop Capital Markets** **Merrill Lynch & Co.**

Oppenheimer & Co. Inc. **Popular Securities** **RBC Capital Markets**

Samuel A. Ramírez & Co. **Santander Securities** **Scotia Capital**

Wachovia Capital Markets LLC

September 5, 2008

Commonwealth of Puerto Rico

Governor

ANÍBAL ACEVEDO VILÁ

Members of the Cabinet

JORGE P. SILVA-PURAS
Chief of Staff

FERNANDO J. BONILLA
Secretary of State

ROBERTO J. SÁNCHEZ RAMOS
Secretary of Justice

ANGEL ORTÍZ GARCIA
Acting Secretary of the Treasury

RAFAEL ARAGUNDE TORRES
Secretary of Education

ROMÁN M. VELASCO GONZÁLEZ
Secretary of Labor and Human Resources

ROSA PÉREZ PERDOMO
Secretary of Health

GABRIEL FIGUEROA HERRERA
Secretary of Agriculture

CARLOS GONZÁLEZ MIRANDA
Secretary of Transportation and Public Works

BARTOLOMÉ GAMUNDI CESTERO
Secretary of Economic Development and Commerce

FÉLIX MATOS
Secretary of Family Affairs

JORGE RIVERA JIMÉNEZ
Secretary of Housing

JAVIER VÉLEZ AROCHO
Secretary of Natural and Environmental Resources

VÍCTOR A. SUÁREZ
Secretary of Consumer Affairs

DAVID E. BERNIER RIVERA
Secretary of Sports and Recreation

MIGUEL A. PEREIRA
Secretary of Corrections and Rehabilitation

Legislative Officers

KENNETH D. MCCLINTOCK
President, Senate

JOSÉ F. APONTE
Speaker, House of Representatives

Fiscal Officers

ARMANDO A. VALDEZ
Director, Office of Management and Budget

JORGE IRIZARRY HERRÁNS
President, Government Development Bank for Puerto Rico

No dealer, broker, sales representative or other person has been authorized by the Commonwealth to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the Commonwealth. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds, by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. The information set forth herein has been obtained from the Commonwealth and other official sources that are believed to be reliable. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Commonwealth since the date hereof. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITERS MAY EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS, AS WELL AS THE OUTSTANDING GENERAL OBLIGATION BONDS OF THE COMMONWEALTH, AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

CERTAIN STATEMENTS CONTAINED IN THIS OFFICIAL STATEMENT REFLECT NOT HISTORICAL FACTS BUT FORECASTS AND “FORWARD-LOOKING STATEMENTS”. THESE STATEMENTS ARE BASED UPON A NUMBER OF ASSUMPTIONS AND ESTIMATES THAT ARE SUBJECT TO SIGNIFICANT UNCERTAINTIES, MANY OF WHICH ARE BEYOND THE CONTROL OF THE COMMONWEALTH OF PUERTO RICO. IN THIS RESPECT, THE WORDS “ESTIMATES”, “PROJECTS”, “ANTICIPATES”, “EXPECTS”, “INTENDS”, “BELIEVES” AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. ALL PROJECTIONS, FORECASTS, ASSUMPTIONS, EXPRESSIONS OF OPINIONS, ESTIMATES AND OTHER FORWARD-LOOKING STATEMENTS ARE EXPRESSLY QUALIFIED IN THEIR ENTIRETY BY THIS CAUTIONARY STATEMENT: ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE EXPRESSED OR IMPLIED BY FORWARD-LOOKING STATEMENTS.

[This page intentionally left blank]

TABLE OF CONTENTS

TABLE OF CONTENTS
(continued)

$250,000,000
COMMONWEALTH OF PUERTO RICO
Public Improvement Bonds of 2008, Series A
(General Obligation Bonds)

INTRODUCTORY STATEMENT

This Official Statement of the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico"), which includes the cover page, the table of contents and the appendices, provides certain information in connection with the sale of $250,000,000 aggregate principal amount of Commonwealth of Puerto Rico Public Improvement Bonds of 2008, Series A (the "Bonds").

The Bonds are being issued under the provisions of Act No. 243 of the Legislature of Puerto Rico (the "Legislature"), approved August 9, 2008, as supplemented by Joint Resolution No. 905 of the Legislature, approved on August 9, 2008 (collectively, the "Act"), and pursuant to a resolution authorizing the issuance of the Bonds (the "Bond Resolution"), adopted in accordance with the Act by the Acting Secretary of the Treasury of Puerto Rico (the "Secretary" or the "Secretary of the Treasury") and approved by the Governor of Puerto Rico on September 5, 2008.

Under the Act, the good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the Bonds. The Constitution of Puerto Rico provides that public debt of the Commonwealth, which includes the Bonds, constitutes a first claim on available Commonwealth resources.

This Official Statement includes the Commonwealth's Financial Information and Operating Data Report, dated May 31, 2008 (the "Commonwealth Report"), attached hereto as *Appendix I*, and the Commonwealth's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2007, prepared by the Department of the Treasury of the Commonwealth (the "Commonwealth's Annual Financial Report"), attached hereto as *Appendix II*. The Commonwealth Report attached hereto as *Appendix I* includes important operating and financial information about the Commonwealth, including information about its economy, historical revenues and expenditures of its General Fund, the estimated year-end results of fiscal year 2008, the budget for fiscal years 2008 and 2009, and the debt of the Commonwealth's public sector, and should be read in its entirety and in conjunction with the *Recent Developments* herein. The Commonwealth's Annual Financial Report includes the basic financial statements of the Commonwealth as of and for the fiscal year ended June 30, 2007, which have been audited by KPMG LLP, independent auditors, as stated in their report dated June 15, 2008, accompanying such financial statements. KPMG LLP did not audit the financial statements of the Public Buildings Authority capital project fund or the Children's Trust special revenue funds (major funds), and certain activities, funds and component units separately identified in its report. Those financial statements were audited by other auditors whose reports have been furnished to KPMG LLP, and its opinions, insofar as they relate to the amounts included for activities, funds and component units, separately identified in its report, are based solely on the reports of the other auditors. The Commonwealth's Annual Financial Report has been filed by the Commonwealth with each nationally recognized municipal securities information repository ("NRMSIR").

Any appendix of an Official Statement of the Commonwealth or of any instrumentality of the Commonwealth containing any revision to the Commonwealth Report or to the Commonwealth's Annual Financial Report that is filed with each NRMSIR and the Municipal Securities Rulemaking Board, or any new or revised Commonwealth Report or Commonwealth Annual Financial Report or other document containing information that modifies or supersedes the information contained in the Commonwealth Report or in the Commonwealth's Annual Financial Report that is filed with each NRMSIR, in each case after the date hereof and prior to the termination of the offering of the Bonds, shall be deemed to be incorporated by reference into this Official Statement and to be part of this Official Statement from the date of filing of such document. Any statement contained in the Commonwealth's Annual Financial Report shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any such subsequently filed document modifies or supersedes such statement. Any statement contained in the Commonwealth Report or elsewhere herein shall also be deemed to be modified or superseded to the extent that a statement contained in any such subsequently filed document modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

Under its existing continuing disclosure agreements, the Commonwealth is obligated to file on or before May 1 in each year updates of its financial and demographic information through the end of the prior fiscal year, including the Commonwealth's Annual Financial Report. In the recent past, the Commonwealth has been unable, due to accounting rules changes and other reasons (mostly related to delays in receipt of component units' audited financial statements), to file the Commonwealth's Annual Financial Report by the May 1 continuing disclosure update filing deadline. See *Continuing Disclosure* herein. The Commonwealth's Annual Financial Report for the fiscal year ended June 30, 2007 was filed with each NRMSIR on June 15, 2008.

OVERVIEW

Puerto Rico is located approximately 1,600 miles southeast of New York City. According to the United States Census Bureau, its population was 3,808,610 in 2000. Puerto Rico's political status is that of a commonwealth. The United States and the Commonwealth share a common defense, market, currency and citizenship. The Commonwealth government exercises virtually the same control over its internal affairs as is exercised by the state governments of each of the fifty states over their respective internal affairs, with similar separation of powers among the executive, legislative and judicial branches. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives but no vote. Most federal taxes, except those such as Social Security taxes, which are imposed by mutual consent, are not levied in Puerto Rico. No federal income tax is collected from Puerto Rico residents on income earned in Puerto Rico, except for certain federal employees who are subject to taxes on their salaries. The official languages of Puerto Rico are Spanish and English.

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. Puerto Rico's economy is closely linked to the United States economy. In fiscal year 2007 (which ended on June 30, 2007), the Commonwealth's gross product (preliminary, in current dollars) was $58.712 billion, and personal income per capita (preliminary, in current dollars) was $13,491.

The Constitution of Puerto Rico limits the amount of general obligation debt that the Commonwealth can issue. The Commonwealth's policy has been and continues to be to maintain the level of such debt within a prudent range below the constitutional limitation.

Fiscal responsibility for the Commonwealth is shared among the Department of the Treasury, the Office of Management and Budget ("OMB") and Government Development Bank for Puerto Rico ("Government Development Bank" or the "Bank"). The Department of the Treasury is responsible for collecting most of the Commonwealth's revenues, overseeing preparation of its financial statements and contributing to the preparation of the budget. OMB prepares the Commonwealth's budget and is responsible for monitoring expenditures. Government Development Bank is the fiscal agent and financial advisor to the Commonwealth and its agencies, public corporations and municipalities and coordinates the management of public finances.

Additional information about the Commonwealth can be found in the Commonwealth Report attached hereto as *Appendix I*, including information about the economy, historical revenues and expenditures of the Commonwealth's General Fund, the year-end results of fiscal year 2007, the estimated year-end results for fiscal year 2008 and the approved budget for fiscal year 2009, and the debt of the Commonwealth's public sector. The Commonwealth Report should be read in its entirety.

RECENT DEVELOPMENTS

This section supplements the information appearing in the Commonwealth Report and should be read in conjunction therewith.

Fiscal Year 2008 Preliminary Revenues and Expenditures

As discussed in greater detail in the Commonwealth Report, the budgeted General Fund expenses for fiscal year 2008 were $9.227 billion. Preliminary actual expenditures during fiscal year 2008 were $9.057 billion. Preliminary General Fund revenues for fiscal year 2008 totaled $8.253 billion, which is $418 million less than the Department of the Treasury's revised estimate for that period of $8.671 billion. This amount includes $4.359 billion in revenues from individual and corporate income taxes, $1.088 billion from non-resident withholding taxes, $864 million from excise taxes and $911 million of sales tax revenues. The foregoing difference between the preliminary General Fund revenues and preliminary actual expenses for fiscal year 2008 was covered by a recovery of approximately $287 million more in federal funds than had been budgeted, $150 million from the pending sale of certain government properties, cash flow savings resulting from restructuring of certain outstanding debt, and certain cash management procedures, which include delaying payments to certain vendors for a short period of time (carrying them over into the next fiscal year). The federal funds recovery represented reimbursement of amounts advanced by the Commonwealth's Department of Education during fiscal years 2006 and 2007.

Fiscal Year 2009 Projected Revenues and Expenditures

On July 20, 2008, the Governor signed into law the General Fund budget for fiscal year 2009 of $9.484 billion, or approximately $257 million more than budgeted expenditures for fiscal year 2008 of $9.227 billion. The increase in budgeted expenditures over fiscal year 2008 is mainly due to $105 million from University of Puerto Rico, judiciary and municipal increases based on the legislated formulas and salary increases mandated by law or collective bargaining agreements. An additional $41.2 million is budgeted for the State Election Commission. The General Fund revenue projection for fiscal year 2009 is $8.488 billion, an increase of $235 million, or 2.9%, from preliminary net revenues for fiscal year 2008 of $8.253 billion. The Commonwealth's budgeted expenditures for fiscal year 2009 of $9.484 billion exceed projected revenues of $8.488 by approximately $1 billion. The Commonwealth's economic team is working to enforce spending control measures that have been established to attempt to minimize the budget risk. In connection with the budget approval and in order to cover the approximately $1 billion difference between approved expenditures and projected revenues, legislation was approved and signed by the Governor authorizing the Commonwealth (i) to sell and or transfer delinquent tax receivables up to $1 billion, and (ii) as an exception to the general prohibition against borrowings to balance the budget, to issue limited special obligations of the Commonwealth payable from and collateralized with tax receivables. There is no guaranty that the Commonwealth will be able to issue such limited special obligations in amounts sufficient to cover the expected revenue shortfall in a timely manner, and, if that is the case, other funding sources, such as possible support from Government Development Bank, will have to be secured.

Indictment of Governor of Puerto Rico

In March 2008, the Governor of Puerto Rico and several other individuals were named in federal grand jury indictments relating to the use of political contributions and campaign funds during the period when the Governor was Resident Commissioner in Washington, D.C. In addition, on August 19, 2008, the Governor and other individuals were named in federal grand jury indictments relating to the use of political contributions and campaign funds during the Governor's campaign and after his election as Governor. The Governor has denied any wrongdoing and has stated his intention to remain in his position and present his defense. It is not expected that such developments will have any impact on the fiscal affairs of the Commonwealth or on the payment of any obligations issued by the Commonwealth.

Planning Board Revised Economic Growth Estimates

On February 21, 2008, the Planning Board, as part of its final review of fiscal year 2007 economic statistics indicated that it expected to reduce the 2007 economic growth rate to -1.8% from -1.4% and that the forecast for fiscal years 2008 and 2009 will be lowered on account of the projected length of the current recession. The factors that influenced the Board's fiscal year 2007 indication included reductions in retail sales, private investment (especially in the construction sector) and government investment. Price increases in certain key areas such as energy and raw materials contributed to the Board's numbers as well.

During March 2008, the Planning Board confirmed its reduction of the fiscal year 2007 economic growth rate to -1.8% from -1.4%, and projected that the economic growth rate for the fiscal year ending June 30, 2008 will be -2.1% and the economic growth rate for the fiscal year ending June 30, 2009 will be 2.1%. It is likely, given the continuing economic weakness in certain key economic variables, including employment and economic output, that the Planning Board will lower its prediction of economic growth for the fiscal year ending June 30, 2009. Lower economic growth could lead to lower revenues and an increase in the deficit during such fiscal year.

PLAN OF FINANCING

The net proceeds of the Bonds will be deposited in the 2008 Public Improvements Fund established under the Act and will be used, together with other available funds, to carry out capital improvement programs authorized by the Legislature in the Act.

Sources and Uses of Funds

Sources:

Principal amount of the Bonds	$250,000,000.00
Original issue premium	2,548,747.75
Total sources	$252,548,747.75

Uses:

Deposit into the 2008 Public Improvements Fund	$250,576,263.37
Underwriting discount, legal, printing, and other financing expenses	1,972,484.38
Total uses	$252,548,747.75

THE BONDS

General

The Bonds will be dated, bear interest at such rates, be payable at such times, and mature on the dates and in the principal amounts set forth on the cover page of this Official Statement. The Bonds are subject to redemption at the times and at the prices set forth below under "Redemption." Banco Popular de Puerto Rico will serve as paying agent and registrar (the "Registrar") for the Bonds.

Book-Entry Only System

The following information concerning DTC and DTC's book-entry system has been obtained from DTC. The Commonwealth does not take any responsibility for the accuracy thereof.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered bonds registered in the name of Cede & Co. (DTC's partnership nominee) or such other nominee as may be requested by an authorized representative of DTC. One fully-registered bond certificate will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity, corporate and municipal debt, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of bond certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has S&P's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of a Bond ("Beneficial Owner") will in turn be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive definitive Bonds, except in the event that use of the book-entry system for the Bonds is discontinued as described below.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co, or such other nominee as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the bond documents. For example, Beneficial Owners may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Commonwealth as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on such record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Commonwealth, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, its nominee, or the Commonwealth, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, redemption premium, if any, and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Commonwealth, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Commonwealth or the Registrar. Under such circumstances, in the event that a successor securities depository is not obtained, definitive Bonds will be printed and delivered.

The Commonwealth may decide to discontinue use of the system of book-entry only transfers through DTC (or a successor depository). In that event, definitive Bonds will be printed and delivered.

The information under this caption concerning DTC and DTC's book entry system has been obtained from sources that the Commonwealth believes to be reliable, but the Commonwealth takes no responsibility for the accuracy thereof.

Payments and Transfers

No assurance can be given by the Commonwealth that DTC will make prompt transfer of payments to the Participants or that Participants will make prompt transfer of payments to Beneficial Owners. The Commonwealth is not responsible or liable for payment by DTC or Participants or for sending transaction statements or for maintaining, supervising or reviewing records maintained by DTC or Participants.

For every transfer and exchange of the Bonds, the Beneficial Owners may be charged a sum sufficient to cover any tax, fee or other charge that may be imposed in relation thereto.

Discontinuance of the Book-Entry Only System

In the event that the book-entry only system is discontinued, the following provisions will apply: principal of and redemption premium, if any, on the Bonds shall be payable in lawful money of the United States of America at the principal office of the Registrar in San Juan, Puerto Rico. Interest on the Bonds will be payable by check mailed to the respective addresses (shown on the registration books of the Commonwealth maintained by the Registrar) of the registered owners determined as of the 15th day of the month preceding the interest payment date as shown on the registration books of the Commonwealth maintained by the Registrar. The Bonds offered by virtue of this Official Statement will be issued only as registered bonds without coupons in denominations of $5,000 and whole multiples thereof. The transfer of the Bonds will be registrable and they may be exchanged at the corporate trust office of the Registrar in San Juan, Puerto Rico, upon the payment of any taxes or other governmental charges required to be paid with respect to such transfer or exchange.

Authorization

Section 2 of Article VI of the Constitution of the Commonwealth provides that the power of the Commonwealth to contract and to authorize the contracting of debts shall be exercised as determined by the Legislative Assembly. Pursuant to this power, the Legislative Assembly enacted the Act, which authorizes the Secretary of the Treasury to issue the Bonds pursuant to one or more resolutions adopted by the Secretary of the Treasury and approved by the Governor. In accordance with the Act, the Secretary of the Treasury adopted and the Governor approved the Bond Resolution.

Redemption

Optional Redemption. At the option of the Secretary and upon at least 30 days' notice, the Bonds maturing on or after July 1, 2018 may be redeemed prior to their respective maturities, from any moneys that may be available for that purpose (other than from moneys set aside in respect of any amortization requirement), on or after July 1, 2018, either in whole or in part (and if in part, in such order of maturity as the Secretary shall determine), on any date, at the principal amount of the Bonds to be redeemed, together with accrued interest to the date fixed for redemption, without premium.

Mandatory Redemption. The Bonds maturing July 1, 2023, July 1, 2028, July 1, 2033 and July 1, 2038 are subject to redemption to the extent of the respective amortization requirements therefor set forth below (less the amount applied to the purchase of any such Bonds and otherwise subject to adjustment as described below), upon at least 30 days' notice, on July 1, 2019, July 1, 2024, July 1, 2029 and July 1, 2034, respectively, and on July 1 in each year thereafter at a redemption price of par plus accrued interest to the dates fixed for redemption:

Amortization Requirements
(due July 1)

Year	2023	2028	2033	2038
2019	$6,145,000			
2020	6,450,000			
2021	6,775,000			
2022	7,110,000			
2023	7,470,000*			
2024		$7,840,000		
2025		8,245,000		
2026		8,665,000		
2027		9,110,000		
2028		9,575,000*		
2029			$10,070,000	
2030			10,610,000	
2031			11,180,000	
2032			11,780,000	
2033			12,415,000*	
2034				$13,080,000
2035				13,865,000
2036				14,695,000
2037				15,580,000
2038				16,515,000*

*Maturity

If the amount of such Bonds purchased or redeemed in a fiscal year exceeds the amount of the amortization requirement for such Bonds for such fiscal year, the amortization requirement for such Bonds may be decreased for such subsequent fiscal years and in such amounts aggregating the amount of such excess as the Secretary of the Treasury shall determine.

Notice of Redemption; Effect of Redemption

Any redemption of the Bonds, either in whole or in part, shall be made upon at least 30-days' prior notice by mail to DTC or, if the book-entry only system described above has been discontinued, by registered or certified mail, postage prepaid, to all registered owners of the

Bonds to be redeemed in the manner and under the terms and conditions provided in the Bond Resolution. On the date designated for redemption, notice having been given as provided in the Bond Resolution and moneys for payment of the principal of and accrued interest on the Bonds or portions thereof so called for redemption being held by the Registrar, interest on the Bonds or portions thereof so called for redemption shall cease to accrue.

Each notice of redemption shall contain, among other things, the particular Bonds (or portions thereof) being called for redemption, the redemption date and price and the address at which such Bonds are to be surrendered for payment of the redemption price. Any defect in such notice or the failure so to mail any such notice to DTC in respect of, or the registered owner of, any Bond will not affect the validity of the proceedings for the redemption of any other Bond.

If less than all of the Bonds of any maturity are called for redemption, the particular Bonds called for redemption shall be selected by the Registrar by such method as it deems fair and appropriate, except that so long as the book-entry only system shall remain in effect, in the event of any such partial redemption, DTC shall reduce the credit balances of the applicable DTC Participants in respect of the Bonds by lot, and such DTC Participants shall in turn select those Beneficial Owners whose ownerships interests are to be extinguished by such partial redemption, each by such method as DTC or such DTC Participant, as the case may be, in its sole discretion, deems fair and appropriate.

Security

Provision for Payment of Public Debt

The Act provides that the good faith, credit and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal of and interest on the bonds issued under the provisions of the Act. The Secretary of the Treasury is authorized and directed under the Act to pay the principal of and interest on the Bonds as the same become due and payable from any funds available for such purpose at the Department of the Treasury in the fiscal year in which such payment is due. The Act provides that the provisions contained therein with respect to the payment of the principal of and interest on the Bonds shall be considered to be a continuous appropriation for the Secretary of the Treasury to make such payments, even though no specific appropriations are made for such purposes. The payments under the Act are required to be made pursuant to the provisions of the laws of the Commonwealth that regulate the disbursement of public funds.

The Constitution of Puerto Rico provides that public debt of the Commonwealth will constitute a first claim on available Commonwealth resources. Public debt includes general obligation bonds and notes of the Commonwealth and any payments required to be made by the Commonwealth under its guarantees of bonds and notes issued by its public instrumentalities.

The Commonwealth has allocated certain motor vehicle fuel taxes, crude oil and derivative products excise taxes and license fees to Puerto Rico Highways and Transportation Authority (the “Highways Authority”). The amounts so allocated, however, are subject to first being applied to payment of the principal of and interest on the Commonwealth public debt, but only if and to the extent that all other available revenues of the Commonwealth are insufficient for that purpose. The Commonwealth has never had to apply such amounts to the payment of its public debt.

Since fiscal year 1989, the Commonwealth has pledged to Puerto Rico Infrastructure Financing Authority certain federal excise taxes imposed on alcoholic beverages and tobacco products produced in Puerto Rico and sold in the United States, which taxes are returned to the Commonwealth. The amounts so pledged, however, are subject to first being applied to payment of the principal of and interest on the Commonwealth public debt, but only if and to the extent that all other available revenues of the Commonwealth are insufficient for that purpose. The Commonwealth has never had to apply such amounts to the payment of its public debt.

In 2006, the Commonwealth allocated a portion of the sales tax to service the bonds issued by Sales Tax Financing Corporation to refinance a portion of the Commonwealth's outstanding extra constitutional debt (including the Sales Tax Bonds). The legislation making such allocation provides that the portion so set aside is not "available Commonwealth revenues" for purposes of the above Constitutional provision. No ruling from the Puerto Rico Supreme Court has been solicited as to the validity of such "set aside" vis-a-vis the Constitutional provision referred to above, and the Commonwealth cannot give any assurance that the Puerto Rico Supreme Court when faced with this issue in a properly briefed and litigated proceeding would agree that such segregated sales tax revenues are "unavailable".

The Constitution expressly empowers a holder of bonds and notes evidencing public debt to bring suit against the Secretary of the Treasury to require application of available resources, including surplus, to the payment of principal of and interest on public debt when due.

Special Fund for the Bonds (General Obligation) Debt Service

Act No. 83 of the Legislature of Puerto Rico, approved on August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exempt from taxation. The proceeds of said tax are credited to the Commonwealth Debt Redemption Fund (the "Redemption Fund"), for application to the payment of general obligation bonds and notes of the Commonwealth.

Act No. 39 of the Legislature of Puerto Rico, approved on May 13, 1976, as amended ("Act No. 39"), requires the Secretary of the Treasury to transfer each month from available funds of the Commonwealth to the Redemption Fund such amounts which, together with certain other funds deposited therein, will be equal to the sum of one-sixth of the interest to be paid in the next six months and one-twelfth of the principal to be paid or required to be amortized within the next twelve months on all bonds and notes of the Commonwealth for which its full faith and credit are pledged as the same become due and all bonds and notes of the Commonwealth for which the guaranty of the Commonwealth has been exercised. Moneys in the Redemption Fund are held in trust by Government Development Bank. Act No. 39 provides that the obligation of the Secretary of the Treasury to make the above transfers is cumulative, and the amount of any deficiency in any month shall be added to the amount of transfers required in future months until such deficiency has been fully paid.

Act No. 39 expressly relates to direct obligations of the Commonwealth. It may also apply to the payment of Commonwealth guaranteed obligations of public corporations outstanding prior to the date of its adoption but not to the payment of bonds and other obligations of such public corporations guaranteed by the Commonwealth issued after the date of its adoption.

Payment Record

The Commonwealth has never defaulted on the payment of principal of or interest on any of its debt.

Debt Limitation

Section 2 of Article VI of the Constitution of Puerto Rico provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes theretofore issued which is payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenues raised under the provisions of Commonwealth legislation and covered into the Treasury of Puerto Rico (hereinafter "internal revenues") in the two fiscal years preceding the then current fiscal year. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. Internal revenues consist principally of income taxes, property taxes and excise taxes. Certain revenues, such as federal excise taxes on offshore shipments of alcoholic beverages and tobacco products and customs duties, which are collected by the United States Government and returned to the Treasury of Puerto Rico and motor vehicle fuel taxes and license fees, which are allocated to the Highway Authority, are not included as internal revenues for the purpose of calculating the debt limit, although some of these revenues may be available for the payment of debt service. In addition, the portion of the sales tax allocated to the Sales Tax Financing Corporation is also not included as internal revenues consistent with the legislation creating the Sales Tax Financing Corporation, which legislation provides that such portion is not "available resources" under the Constitutional provisions relating to the Bonds.

All or a portion of the proceeds of certain refunding bonds issued by the Commonwealth were invested in guaranteed investment contracts or federal agency securities (in each case rated in the highest rating category by Moody's and S&P), none of which is eligible to be used for legal defeasance under Puerto Rico law ("non-eligible investments"). Since bonds refunded with proceeds invested in non-eligible investments are not legally defeased, such bonds are treated as outstanding for purposes of the 15% debt limitation.

Joint Resolution No. 2104 of September 30, 2004 ("Joint Resolution No. 2104"), authorized the Commonwealth to enter into interest rate exchange agreements with respect to the Commonwealth's $447,875,000 Public Improvement Refunding Bonds, Series 2004 B (the "Series 2004 B Bonds"), which were issued as variable rate bonds. Joint Resolution No. 2104 allows the Commonwealth to calculate the constitutional debt limitation using (i) the fixed rate it is required to pay under any interest rate exchange agreement entered into by the Commonwealth in connection with the Series 2004 B Bonds, and (ii) the lesser of (A) the maximum interest rate allowed by law, and (B) the maximum interest rate set forth in the resolution approving the bonds, if any, in connection with the Commonwealth's $279,240,000 Public Improvement Refunding Bonds, Series 2004 A (the "Series 2004 A Bonds") and any Series 2004 B Bonds for which no interest rate exchange agreement is executed. In November 2004, the Commonwealth entered into two interest rate exchange agreements with respect to the Series 2004 B Bonds.

Act No. 39 of 2005 authorizes the Commonwealth to enter into interest rate exchange agreements with respect to its general obligation bonds, subject to certain conditions, including that the agreements are entered into to reduce certain financial risks associated with issuing variable rate obligations. In August 2006, the Commonwealth issued its $500,000,000 Public Improvement Bonds of 2006, Series A, a portion of which bonds bear interest at a rate that will change periodically based on changes in the United States consumer price index, and in connection with such consumer price index floating rate bonds (said portion, the "2006 CPI Bonds") entered into an interest rate exchange agreement, the effect of which will economically enable the Commonwealth to pay a fixed rate of interest in respect thereof. In August and September 2006, the Commonwealth entered into interest rate exchange agreements, the effect of which will economically enable the Commonwealth to pay a fixed rate of interest in respect of a portion of the Commonwealth's outstanding $1,018,245,000 Public Improvement Refunding Bonds, Series 2003C (said portion, the "2003C Swap Bonds") and whose payments commenced on July 1, 2008, the end of an initial fixed rate period on the 2003C Swap Bonds. In October 2007, the Commonwealth issued its $926,570,000 Public Improvement Refunding Bonds, Series 2007A, a portion of which bonds bear interest at a variable rate and, in connection with said bonds (said portion, the "2007 Swap Bonds") entered into an interest rate exchange agreement, the effect of which will economically enable the Commonwealth to pay a fixed rate of interest in respect thereof. In May 2008, the Commonwealth issued its $173,975,000 Public Improvement Refunding Bonds, Series 2008B (the "2008 Swap Bonds"), which bear interest at a variable rate, for the purpose of refunding a portion of the Series 2004 B Bonds, and, in connection therewith, continued the swap related to such refunded Series 2004 B Bonds. Act No. 39 of 2005 allows the Commonwealth to calculate the constitutional debt limit in a manner identical to that utilized in Joint Resolution No. 2104. In addition, the Commonwealth has also executed under the authority granted in Act No. 39 of 2005, interest rate exchange agreements in which the Commonwealth is making payments (1) on $1,698,370,000 notional amount of public improvement bonds based on a short-term interest rate index published by Securities Industry and Financial Markets Association ("SIFMA") and is receiving from its counterparties payments on the same notional amount based on the published three-month London Interbank Offered Rate index (the "basis swap") and (2) on $850,000,000 notional amount of public improvement bonds based on the published short-term SIFMA municipal swap rate and is receiving from its counterparties payments on the same notional amount based on a published index of municipal bonds having a maturity of 10 years (the "constant maturity swap").

After giving effect to the issuance of the Bonds, future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $948,102,368 in the fiscal year ending June 30, 2016 (based on the assumption that (i) the bonds refunded with non-eligible investments are treated as being outstanding, (ii) the Series 2004 A Bonds bear interest at their actual rate per annum through July 1, 2012 and thereafter at 12% per annum, (iii) the outstanding 2003C Swap Bonds, Series 2004 B Bonds, 2006 CPI Bonds, 2007 Swap Bonds and the 2008 Swap Bonds, bear interest at 12% per annum and (iv) the public improvement bonds to which the basis swap and the constant maturity swap relate bear interest at their stated interest rates rather than the rates set forth in said swaps). This amount ($948,102,368) is equal to 11.59% of $8,178,090,500, which is the average of the adjusted internal revenues for the fiscal year ended June 30, 2007 and the currently estimated adjusted internal revenues for the fiscal year ended June 30, 2008. If the bonds refunded with non-eligible investments were treated as not being outstanding, and the interest on the outstanding bonds described in items (i) through (iv) above is calculated using the fixed rate paid by the Commonwealth under the interest rate exchange agreements executed in connection with such bonds, the percentage referred to in the preceding sentence would be 9.602%.

Debt service for the Puerto Rico Aqueduct and Sewer Authority ("PRASA") guaranteed bonds of approximately $30 million was paid by PRASA during the last two fiscal years and, thus, is not included in the calculation of the 15% debt limitation. See "Other Public Corporations – Aqueduct and Sewer Authority" under *Public Corporations* in *Appendix I*. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund and such debt service would, to the extent paid by the Commonwealth, be included in the calculation of the 15% debt limitation.

Maturity Limitation

The Constitution provides that no bonds or notes of the Commonwealth shall mature later than 30 years from their date of issue, except bonds or notes for housing facilities, which shall mature in no more than 40 years.

PUBLIC SECTOR DEBT OF THE COMMONWEALTH

Public Sector Debt

The following table presents a summary of the public sector debt of the Commonwealth as of June 30, 2008. The table also shows the public sector debt as further adjusted by the issuance of the Bonds. The table should be read in conjunction with the information set forth under *Debt* in *Appendix I*.

Commonwealth of Puerto Rico
Public Sector Debt*
(in millions)

	June 30, 2008	As Adjusted
Direct full faith and credit obligations[1]	$ 8,759	$ 9,009
TRANs line of credit	-	-
Sales tax debt[2]	7,690	7,690
Municipal debt	2,819	2,819
Puerto Rico guaranteed debt[3]	4,104	4,104
Debt supported by Puerto Rico appropriations or taxes[4]	1,322	1,322
Public corporations and agencies	21,989	21,989
Subtotal	46,682	46,932
Limited obligations/non-recourse debt[5]	$ 6,265	$ 6,265
Total public sector debt	$52,947	$53,197

(1) Includes general obligation bonds and tax and revenue anticipation notes ("TRANs").
(2) Includes Public Finance Corporation and Sales Tax Financing Corporation Bonds.
(3) Consists of $599.3 billion of bonds issued by PRASA, $293.3 million of State Revolving Fund Loans incurred under various federal water laws, $112.4 million of bonds issued by Port of the Americas Authority and $3.099 billion of Public Buildings Authority bonds. Excludes $267 million of Government Development Bank bonds payable from available moneys of bond and notes payable from the Commonwealth General Fund and Public Improvement Fund.
(4) Represents bonds and notes payable from the Commonwealth General Fund and Public Improvement Fund.
(5) Includes the following: $1.2 billion of Children's Trust Bonds which are payable solely from the payments to be received pursuant to the tobacco litigation settlement; $596.3 million of Housing Finance Authority bonds, which are payable from Puerto Rico Housing Administration's annual allocation of Public Housing Capital Funds from the United States Department of Housing and Urban Development; $153 million of Special Facilities Revenue Bonds issued by the Highways and Transportation Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge; $155 million of Special Facilities Bonds issued by the Ports Authority, which are solely payable from the pledge of certain payments made by a private corporation under a special facilities agreement; $81.2 million of Educational Facilities Revenue Bonds, 200 Series A (University Plaza Project) issued by the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority, which are payable from rent payments made by the University of Puerto Rico; approximately $84.7 million of bonds issued by the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority to finance the construction of various government infrastructure projects, which are payable from rent payments made by various government entities; and $2.948 billion of Employees Retirement System Senior Pension Funding Bonds, Series A, B and C.
* For a complete recital of all notes to this table, see "Public Sector Debt" under Debt in Appendix I.
Source: Government Development Bank

Debt Service Requirements for Commonwealth General Obligation Bonds and Certain Guaranteed Debt

The following table presents the debt service requirements for (i) Commonwealth general obligation bonds outstanding on June 30, 2008; (ii) the Bonds; and (iii) total Commonwealth general obligation bonds, adjusted for the issuance of the Bonds. The table excludes debt service on Commonwealth general obligation bonds that have been refunded with the proceeds of refunding bonds invested in non-eligible investments, notwithstanding that such bonds will be considered to be outstanding under their authorizing resolution and for purposes of calculating the Commonwealth's debt limitation. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

Commonwealth of Puerto Rico
Debt Service Requirements*
(in thousands)

Fiscal Year Ending June 30,	Outstanding Bonds Total Debt Service[1]	The Bonds Principal	The Bonds Interest	Grand Total[2]
2009	$ 403,232	$ -	$ 10,735	$ 413,967
2010	745,679	3,850	13,655	763,185
2011	743,130	4,040	13,463	760,633
2012	749,874	4,245	13,261	767,379
2013	752,991	4,455	13,049	770,495
2014	740,525	4,700	12,804	758,029
2015	754,599	4,960	12,545	772,104
2016	754,455	5,230	12,272	771,957
2017	680,151	5,520	11,985	697,656
2018	664,202	5,825	11,681	681,708
2019	732,870	6,145	11,361	750,375
2020	767,795	6,450	11,053	785,298
2021	615,480	6,775	10,731	632,986
2022	526,032	7,110	10,392	543,534
2023	480,444	7,470	10,037	497,950
2024	458,368	7,840	9,663	475,871
2025	460,032	8,245	9,261	477,538
2026	450,424	8,665	8,839	467,927
2027	448,739	9,110	8,395	466,244
2028	449,148	9,575	7,928	466,651
2029	405,266	10,070	7,437	422,773
2030	401,244	10,610	6,896	418,750
2031	404,123	11,180	6,326	421,628
2032	223,992	11,780	5,725	241,497
2033	186,032	12,415	5,091	203,539
2034	132,007	13,080	4,424	149,512
2035	61,497	13,865	3,639	79,001
2036	33,676	14,695	2,807	51,178
2037	33,680	15,580	1,926	51,186
2038	-	16,515	991	17,506
Total	$14,259,687	$250,000	$268,369	$14,778,055

* Totals may not add due to rounding. Excludes the debt service on certain economically (but not legally) defeased general obligation bonds and includes the effective fixed rate on certain variable rate general obligation bonds as to which the Commonwealth has entered into interest rate exchange agreements.

(1) In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund.

(2) Debt service requirements on all general obligation bonds outstanding, adjusted as discussed in footnote 1 above and further adjusted to include the issuance of the Bonds.

Sources: Government Development Bank and Department of the Treasury

TAX MATTERS

The Internal Revenue Code of 1986, as amended (the "Code"), includes requirements regarding the use, expenditure and investment of bond proceeds and the timely payment of certain investment earnings to the Treasury of the United States, if required, which must continue to be satisfied after the issuance of the Bonds in order that interest on the Bonds not be included in gross income for federal income tax purposes. The failure to meet these requirements may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactive to their date of issuance. The Commonwealth has covenanted to comply, to the extent permitted by the Constitution and the laws of the Commonwealth, with the requirements of the Code in order to maintain the exclusion from gross income for federal income tax purposes of interest on the Bonds. Bond Counsel is not aware of any provision of the Constitution or laws of the Commonwealth which would prevent the Commonwealth from complying with the requirements of the Code.

In the opinion of Bond Counsel, subject to continuing compliance by the Commonwealth with the tax covenant referred to above, under the provisions of the Acts of Congress now in force and under existing regulations, rulings and court decisions, interest on the Bonds will not be includable in gross income for federal income tax purposes. Interest on the Bonds will not be an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Bonds will, however, be includable in the computation of the alternative minimum tax on corporations imposed by the Code. Bond Counsel expresses no opinion as to the effect of any change to any document pertaining to the Bonds, or the Composite Issue (defined below) if applicable, or of any action taken or not taken where such change is made or action is taken or not taken without its approval or in reliance upon the advice of counsel other than such firm with respect to the exclusion from gross income of the interest on the Bonds for federal income tax purposes. Bond Counsel is further of the opinion that under the provisions of the Acts of Congress now in force, the Bonds and the interest thereon will be exempt from state, Commonwealth and local income taxation.

The Commonwealth entered into a binding contract with the Underwriters on September 5, 2008 to sell the Bonds (the "Sales Date of the Bonds"). It is expected that the Puerto Rico Public Buildings Authority (the "Public Buildings Authority") will convert its $150,000,000 Government Facilities Revenue Refunding Bonds, Series M-3, Guaranteed by the Commonwealth of Puerto Rico (the "Series M-3 Bonds") from a weekly rate period to a long-term interest rate period and remarket the Series M-3 Bonds (the "Conversion"). Pursuant to the Conversion, the Public Buildings Authority reasonably expects to enter into a binding contract on or about September 18, 2008, to sell the Series M-3 Bonds. The Public Buildings Authority has retained the law firm of Squire, Sanders & Dempsey L.L.P. to serve as bond counsel in connection with the Conversion. If the Series M-3 Bonds are treated as "reissued" for federal income tax purposes as a result of the Conversion and the Public Buildings Authority enters into a binding contract for the sale of the Series M-3 Bonds pursuant to such Conversion within 14 days of the Sales Date of the Bonds, the Series M-3 Bonds as converted (the "Converted Series M-3 Bonds") and the Bonds may be treated as a single issue of obligations for federal income tax purposes (the "Composite Issue"). In rendering its opinion that interest on the Bonds is excludable from gross income for federal income tax purposes, Sidley Austin LLP is relying on the opinion of Squire, Sanders & Dempsey L.L.P. that the interest on the Converted Series M-3

Bonds is excludable from gross income for federal income tax purposes. To the extent that the Converted Series M-3 Bonds are treated as a Composite Issue with the Bonds, failure by the Public Buildings Authority to comply with the requirements of the Code with respect to the Converted Series M-3 Bonds may cause interest on the Bonds to be included in gross income for federal income tax purposes retroactively to the date of issue of the Bonds.

Ownership of tax-exempt obligations such as the Bonds may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations, certain S Corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations and taxpayers who may be eligible for the earned income tax credit.

Ownership of tax-exempt obligations such as the Bonds may also result in collateral income tax consequences under Puerto Rico law to financial institutions doing business in Puerto Rico.

Prospective purchasers of the Bonds should consult their tax advisors as to the applicability and impact of any collateral consequences.

Discount Bonds

The excess, if any, of the amount payable at maturity of any maturity of the Bonds over the issue price thereof constitutes original issue discount. The amount of original issue discount that has accrued and is properly allocable to an owner of any maturity of the Bonds with original issue discount (a "Discount Bond") will be excluded from gross income for federal income tax purposes to the same extent as interest on the Bonds. In general, the issue price of a maturity of the Bonds is the first price at which a substantial amount of Bonds of that maturity was sold (excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers) and the amount of original issue discount accrues in accordance with a constant yield method based on the compounding of interest. A purchaser's adjusted basis in a Discount Bond will be increased by the amount of such accruing discount for purposes of determining taxable gain or loss on the sale, redemption or other disposition of such Discount Bond for federal income tax purposes.

A portion of the original issue discount that accrues in each year to a Bond owner of a Discount Bond that is a corporation will be included in the calculation of the corporation's federal alternative minimum tax liability. In addition, original issue discount that accrues in each year to an owner of a Discount Bond is included in the calculation of the distribution requirements of certain regulated investment companies and may result in some of the collateral federal income tax consequences discussed herein. Consequently, an owner of a Discount Bond should be aware that the accrual of original issue discount in each year may result in an alternative minimum tax liability, additional distribution requirements or other collateral federal income tax consequences although the owner of such Discount Bond has not received cash attributable to such original issue discount in such year.

The accrual of original issue discount and its effect on the redemption, sale or other disposition of any maturity of a Discount Bond that is not purchased in the initial offering at the first price at which a substantial amount of Discount Bond of that maturity is sold to the public may be determined according to rules that differ from those described above. An owner of a Discount Bond should consult his tax advisor with respect to the determination for federal income tax purposes of the amount of original issue discount with respect to such Discount Bond and with respect to state, Commonwealth and local tax consequences of owning and disposing of such Discount Bond.

Premium Bonds

The excess, if any, of the tax basis of a Bond to a purchaser in the initial public offering of the Bonds (other than a purchaser who holds such Bonds as inventory, stock in trade or for sale to customers in the ordinary course of business) over the amount payable at maturity of that Bond is "Bond Premium." Bond Premium is amortized over the term of such Bond for federal income tax purposes (in the case of a Bond with Bond Premium callable prior to its stated maturity, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such Bond). No deduction is allowed for such amortization of Bond Premium. Bond Premium is, however, treated as an offset to qualified stated interest received on the Bonds. An owner of such Bond is required to decrease his adjusted basis in such Bond by the amount of amortizable bond premium attributable to each taxable year such Bond is held. An owner of such Bond should consult his tax advisor with respect to the precise determination for federal income tax purposes of the treatment of Bond Premium upon sale, redemption or other disposition of such Bond and with respect to Commonwealth, state, and local income tax consequences of owning and disposing of such Bond.

Information Reporting and Backup Withholding

Interest paid on tax-exempt obligations is subject to information reporting in a manner similar to interest paid on taxable obligations. While this reporting requirement does not, by itself, affect the excludability of interest from gross income for federal income tax purposes, the reporting requirement causes the payment of interest on the Bonds to be subject to backup withholding if such interest is paid to beneficial owners that (a) are not "exempt recipients," and (b) either fail to provide certain identifying information (such as the beneficial owner's taxpayer identification number) in the required manner or have been identified by the Internal Revenue Service (the "IRS") as having failed to report all interest and dividends required to be shown on their income tax returns. Generally, individuals are not exempt recipients, whereas corporations and certain other entities are exempt recipients. Amounts withheld under the backup withholding rules from a payment to a beneficial owner are allowed as a refund or credit against such beneficial owner's federal income tax liability so long as the required information is furnished to the IRS.

Future Developments

Future legislative proposals, if enacted into law, regulations, rulings or court decisions may cause interest on the Bonds to be subject, directly or indirectly, to federal income taxation or to state, Commonwealth or local income taxation, or otherwise prevent beneficial owners from realizing the full current benefit of the exclusion of such interest. Prospective purchasers of the Bonds should consult their tax advisors regarding any pending or proposed federal, state, Commonwealth or local tax legislation, regulations, rulings or litigation as to which Bond Counsel expresses no opinion.

APPROVAL OF LEGAL PROCEEDINGS

Legal matters incident to the authorization and issuance of the Bonds are subject to the approval of Sidley Austin LLP, New York, New York, Bond Counsel, the proposed forms of whose opinions are included herein as *Appendix III*. Certain legal matters will be passed upon for the Underwriters by Squire, Sanders & Dempsey L.L.P., Miami, Florida.

LEGAL INVESTMENT

The Bonds will be eligible for deposit by banks in Puerto Rico to secure public funds and will be approved investments for insurance companies to qualify them to do business in Puerto Rico, as required by law.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Bonds from the Commonwealth at an aggregate discount of $1,355,984.38 from the initial offering prices of the Bonds set forth on the cover page hereof. The obligation of the Underwriters to purchase the Bonds is subject to certain conditions precedent, and they will be obligated to purchase all the Bonds if any Bonds are purchased. The Underwriters may offer to sell the Bonds to certain dealers and others at prices lower than the initial public offering prices. The offering prices may be changed, from time to time, by the Underwriters.

BBVAPR MSD ("BBVA") and RBC Capital Markets Corporation ("RBC"), have entered into an agreement under which the parties provide services and advice to each other to assist the Commonwealth and its issuers in the structuring and execution of their municipal securities offerings. As part of the agreement, BBVA and RBC share in the risk from the underwriting of the Bonds as part of the consideration for their professional services.

Popular Securities, Inc, ("Popular") has entered into a joint venture agreement (the "JV Agreement") with Morgan Stanley & Co. Incorporated ("Morgan Stanley"), under which the parties shall provide services and advice to each other related to the structuring and execution of certain municipal finance transactions in the U.S. capital markets with governmental entities located in the Commonwealth. Pursuant to the terms of the JV Agreement and in compliance with applicable rules, the parties will be entitled to receive a portion of each other's net profits from the underwriting of the Bonds as consideration for their professional services.

Santander Securities Corporation ("SSC") and Banc of America Securities LLP ("BAS") have entered into an agreement to jointly pursue municipal securities underwriting opportunities with the Commonwealth, its agencies, municipalities and governmental conduit issuers in the Commonwealth. Under the agreement SSC and BAS will be entitled to receive a portion of each other's revenues from the underwriting of the Bonds in consideration for their professional services.

Loop Capital LLC ("LC") and TCM Capital, Inc. ("TCM") have entered into an agreement to jointly pursue municipal securities underwriting opportunities with the Commonwealth, its agencies, municipalities and governmental conduit issuers in the Commonwealth. Under the agreement LC and TCM will be entitled to receive a portion of each other's revenues from the underwriting of the Bonds in consideration for their professional services.

J.P. Morgan Securities Inc. ("JPMSI") and Scotia Capital (USA) Inc. ("SCUSA") have entered into an agreement to assist the Commonwealth, its public corporations, agencies, instrumentalities, and municipalities in structuring and facilitating the issuance of their municipal securities. For each issuance of municipal securities for which both parties act as co-senior manager or co-manager, any sales commissions or takedowns shall be allocated based on actual sales of municipal securities by JPMSI or SCUSA.

Oppenheimer & Co. Inc. ("Oppenheimer") and Eurobank Municipal Securities Dealer ("Eurobank MSD") have entered into an agreement to jointly pursue municipal securities underwriting opportunities with the Commonwealth, its agencies, municipalities and governmental conduit issuers in the Commonwealth. Under the agreement Oppenheimer and Eurobank MSD will be entitled to receive a portion of each other's revenues from the underwriting of the Bonds in consideration for their professional services.

GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

As required by Act No. 272 of the Legislature of Puerto Rico, approved May 15, 1945, as amended, Government Development Bank has acted as financial advisor to the Commonwealth in connection with the Bonds offered hereby. As financial advisor, Government Development Bank participated in the selection of the Underwriters of the Bonds. Certain of the Underwriters have been selected by Government Development Bank to serve from time to time as underwriters of its obligations and the obligations of the Commonwealth, its instrumentalities and public corporations. Certain of the Underwriters or their affiliates also participate in other financial transactions with Government Development Bank.

RATINGS

Moody's and S&P have given the Bonds ratings of "Baa3" and "BBB-", respectively. Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency. Such rating agencies were provided with materials relating to the Commonwealth and the Bonds and other relevant information, and no application has been made to any other rating agency for the purpose of obtaining a rating on the Bonds.

Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency. Such rating agencies were provided with materials relative to the Commonwealth and the Bonds and other relevant information, and no application has been made to any other rating agency for the purpose of obtaining a rating on the Bonds. There is no assurance that such ratings will remain in effect for any given period of time or that they will not be revised downward or withdrawn entirely by either or both of such rating agencies, if in the judgment of either or both, circumstances so warrant. Any such downward revision or withdrawal of such ratings, or either of them, may have an adverse effect on the market prices of the Bonds.

CONTINUING DISCLOSURE

In accordance with the requirements of Rule 15c2-12, as amended (the "Rule"), promulgated by the Securities and Exchange Commission (the "SEC"), the Commonwealth has covenanted in the Bond Resolution for the benefit of the Beneficial Owners (as defined in the Bond Resolution):

1. to file, within 305 days after the end of each fiscal year commencing with the fiscal year ending June 30, 2008, with each NRMSIR and with any Commonwealth state information depository ("SID"), core financial information and operating data for the prior fiscal year, including (i) the Commonwealth's audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data (including financial information and operating data) on the Commonwealth and its revenues, expenditures, financial operations and indebtedness, in each case generally found in this Official Statement; and

2. to file, in a timely manner, with each NRMSIR or with the Municipal Securities Rulemaking Board and with each Commonwealth SID, notice of any failure of the Commonwealth to comply with paragraph 1 above and of the occurrence of any of the following events with respect to the Bonds, if material:

    a. principal and interest payment delinquencies;
    b. non-payment related defaults;
    c. unscheduled draws on debt service reserves reflecting financial difficulties;
    d. unscheduled draws on credit enhancements reflecting financial difficulties;
    e. substitution of credit or liquidity facility providers, or their failure to perform;
    f. adverse opinions or events affecting the tax-exempt status of the Bonds;
    g. modifications to rights of the holders (including Beneficial Owners) of the Bonds;
    h. bond calls;
    i. defeasances;
    j. release, substitution, or sale of property securing repayment of the Bonds; and
    k. rating changes.

Event (c) is included pursuant to a letter from the SEC staff to the National Association of Bond Lawyers, dated September 19, 1995. However, event (c) may not be applicable, since the terms of the Bonds do not provide for “debt service reserves.” In addition, with respect to the following events:

Events (d) and (e). The Commonwealth does not undertake to provide any notice with respect to credit enhancement added after the primary offering of the Bonds, unless the Commonwealth applies for or participates in obtaining the enhancement.

Event (f). For information on the tax status of the Bonds, see *Tax Matters*.

Event (h). The Commonwealth does not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if the terms, dates and amounts of redemption are set forth in detail in this Official Statement under “*The Bonds* — Redemption”, the only open issue is which Bonds will be redeemed in the case of a partial redemption, notice of redemption is given to the Bondholders as required under the terms of the Bonds, and public notice of the redemption is given pursuant to Securities Exchange Act of 1934 Release No. 34-23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or purchases of Bonds.

The Commonwealth expects to provide the information described in paragraph 1 above by filing its first bond official statement that includes such information for the preceding fiscal year or, if no such official statement is issued by the 305-day deadline, by filing a separate document containing such information.

The Commonwealth has made similar continuing disclosure covenants in connection with prior bond issuances, and has complied with all such covenants, except as hereinafter noted. The Commonwealth’s audited financial statements for the fiscal year ended June 30, 2002 were filed after the Commonwealth’s filing deadline of May 1, 2003 because of delays in finalizing such financial statements resulting from the implementation of GASB Statement No. 34 (“GASB 34”). The Commonwealth’s audited financial statements for the fiscal year ended June 30, 2003 were also filed after the Commonwealth’s filing deadline of April 30, 2004, because of delays in finalizing the financial statements of certain of the Commonwealth’s reporting units due to the implementation of GASB 34. The Commonwealth’s audited financial statements for the fiscal years ended June 30, 2004, 2006 and 2007 were also filed after the Commonwealth’s respective filing deadlines of May 1, 2005, 2007 and 2008, because various governmental agencies did not submit their audited financial statements to the central government’s external auditors on time, thereby delaying submission of the Commonwealth’s audited financial statements.

As of the date of this Official Statement, there is no Commonwealth SID, and the NRMSIRs are: Bloomberg Municipal Repository, 100 Business Park Drive, Skillman, New Jersey 08558; Standard & Poor’s Securities Evaluations, Inc., 55 Water Street, 45th Floor, New York, New York 10041; Interactive Data Pricing and Reference Data, Inc., Attn: NRMSIR, 100 William Street, 15th Floor, New York, New York 10038; and DPC Data Inc., One Executive Drive, Fort Lee, New Jersey 07024.

The Commonwealth may from time to time choose to provide notice of the occurrence of certain other events in addition to those listed above if, in the judgment of the Commonwealth, such other events are material with respect to the Bonds, but the Commonwealth does not undertake to provide any such notice of the occurrence of any material event except those events listed above.

The Commonwealth acknowledges that its undertaking pursuant to the Rule described above is intended to be for the benefit of the Beneficial Owners of the Bonds, and shall be enforceable by any such Beneficial Owners; provided that the right to enforce the provisions of its undertaking shall be limited to a right to obtain specific enforcement of the Commonwealth's obligations thereunder.

No Beneficial Owner may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of the foregoing covenants (the "Covenants") or for any remedy for breach thereof, unless such Beneficial Owner shall have filed with the Commonwealth written notice of any request to cure such breach, and the Commonwealth shall have refused to comply within a reasonable time. All Proceedings shall be instituted only in a Commonwealth court located in the Municipality of San Juan, Puerto Rico for the equal benefit of all Beneficial Owners of the outstanding Bonds benefited by the Covenants, and no remedy shall be sought or granted other than specific performance of any of the Covenants at issue. Moreover, Proceedings filed by Beneficial Owners against the Commonwealth may be subject to the sovereign immunity provisions of Section 2 and 2A of Act No. 104, approved June 29, 1955, as amended, which governs the scope of legal actions against the Commonwealth, substantially limits the amount of monetary damages that may be awarded against the Commonwealth and provides certain notice provisions, the failure to comply with which may further limit any recovery.

The Covenants may only be amended if:

(1) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Commonwealth, or type of business conducted; the Covenants, as amended, would have complied with the requirements of the Rule at the time of award of the Bonds, after taking into account any amendments or change in circumstances; and the amendment does not materially impair the interest of Beneficial Owners, as determined by persons unaffiliated with the Commonwealth; or

(2) all or any part of the Rule, as interpreted by the staff of the SEC at the date of the adoption of such Rule, ceases to be in effect for any reason, and the Commonwealth elects that the Covenants shall be deemed amended accordingly.

The Commonwealth has further agreed that the annual financial information containing any amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

Any assertion of beneficial ownership must be filed, with full documentary support, as part of the written request described above.

MISCELLANEOUS

The foregoing summaries of or references to the Act, the Bonds, the Bond Resolution, and the other documents and agreements referred to herein and the summaries of or references to the various acts contained in the Commonwealth Report, are made subject to all the detailed provisions thereof to which reference is hereby made for further information and do not purport to be complete statements of any or all of such provisions.

Appended to and constituting a part of this Official Statement are the Commonwealth Report (*Appendix I*), the Commonwealth's Annual Financial Report (*Appendix II*) and the proposed form of opinion of Bond Counsel (*Appendix III*).

The information set forth in this Official Statement and incorporated herein by reference, except for information pertaining to DTC, was supplied by certain officials of the Commonwealth or certain of its agencies or instrumentalities, in their respective official capacities, or was obtained from publications of the Commonwealth or certain of its agencies or instrumentalities, and is included or incorporated by reference in this Official Statement on the authority of such officials or the authority of such publications as public official documents. The information pertaining to DTC was supplied by DTC.

This Official Statement will be filed with each NRMSIR and with the Municipal Securities Rulemaking Board.

COMMONWEALTH OF PUERTO RICO

By: /s/ Angel Ortíz Garcia
Acting Secretary of the Treasury

APPENDIX I

COMMONWEALTH OF PUERTO RICO
Financial Information and Operating Data Report
May 31, 2008

[THIS PAGE INTENTIONALLY LEFT BLANK]

TABLE OF CONTENTS

TABLE OF CONTENTS
(continued)

Page

COMMONWEALTH OF PUERTO RICO
Financial Information and Operating Data Report
May 31, 2008

INTRODUCTION

General

The operating and financial information about the Commonwealth included in this Report has been updated as of May 31, 2008, except as to certain information which has been updated as of different dates, as set forth herein.

Geographic Location and Demography

Puerto Rico, the fourth largest of the Caribbean islands, is located approximately 1,600 miles southeast of New York City. It is approximately 100 miles long and 35 miles wide.

According to the United States Census Bureau, the population of Puerto Rico was 3,808,610 in 2000 (3,927,776 as of July 1, 2006 according to a Census Bureau estimate), compared to 3,522,000 in 1990. As of 2000, the population of San Juan, the island's capital and largest city, was 434,375.

Relationship with the United States

Puerto Rico was discovered by Columbus in 1493 and shortly thereafter the island was conquered and settled by the Spaniards. It remained a Spanish possession for four centuries.

Puerto Rico came under United States sovereignty pursuant to the Treaty of Paris, signed on December 10, 1898, which ended the Spanish-American War. Puerto Ricans have been citizens of the United States since 1917. In 1950, after a long evolution toward greater self-government for Puerto Rico, the Congress of the United States enacted Public Law 600, which is "in the nature of a compact" and which became effective upon its acceptance by the electorate of Puerto Rico. It provides that those sections of existing law which defined the political, economic, and fiscal relationship between Puerto Rico and the United States would remain in full force. It also authorized the people of Puerto Rico to draft and adopt their own Constitution. The Constitution was drafted by a popularly elected constitutional convention, overwhelmingly approved in a special referendum by the people of Puerto Rico and approved by the United States Congress and the President of the United States, becoming effective upon proclamation of the Governor of Puerto Rico on July 25, 1952. Puerto Rico's relationship with the United States is referred to herein as commonwealth status.

The United States and the Commonwealth of Puerto Rico (the "Commonwealth" or "Puerto Rico") share a common defense, market, and currency. The Commonwealth exercises virtually the same control over its internal affairs as do the 50 states. It differs from the states, however, in its relationship with the federal government. The people of Puerto Rico are citizens of the United States but do not vote in national elections. They are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives but no vote. Most federal taxes, except those such as Social Security taxes which are imposed by mutual consent, are not levied in Puerto Rico. No federal income tax is collected from Puerto Rico residents on income earned in Puerto Rico, except for certain federal employees who are subject to taxes on their salaries.

The official languages of Puerto Rico are Spanish and English.

Governmental Structure

The Constitution of the Commonwealth provides for the separation of powers of the executive, legislative, and judicial branches of government. The Governor is elected every four years. The Legislative Assembly consists of a Senate and a House of Representatives, the members of which are elected for four-year terms. The highest court within the local jurisdiction is the Supreme Court of Puerto Rico. Puerto Rico constitutes a District in the federal judiciary and has its own United States District Court. Decisions of this court may be appealed to the United States Court of Appeals for the First Circuit and from there to the Supreme Court of the United States.

Governmental responsibilities assumed by the central government of the Commonwealth are similar in nature to those of the various state governments. In addition, the central government assumes responsibility for local police and fire protection, education, public health and welfare programs, and economic development.

Principal Officials Responsible for Fiscal Matters

Aníbal Acevedo Vilá was sworn in as Governor of Puerto Rico on January 2, 2005. He is a graduate of the University of Puerto Rico, where he obtained a Bachelor's degree in Political Science and a Juris Doctor degree. He obtained an L.L.M. from Harvard Law School and served as law clerk for Puerto Rico Supreme Court Judge Federico Hernández Denton and for U.S. First Circuit Court of Appeals Judge Levin Campbell. He also served in the public sector as legislative adviser to the Governor of Puerto Rico. From 1993 to 2001, he served as an elected member of the Puerto Rico House of Representatives. From 2001 until assuming his position as Governor, he served as the elected Resident Commissioner of the Commonwealth in the U.S. House of Representatives.

Ángel Ortíz García was named Acting Secretary of the Puerto Rico Department of the Treasury (the "Treasury") on May 30, 2008. He is a certified public accountant and a lawyer. He graduated from the University of Puerto Rico, where he obtained a Bachelor's degree in accounting and a Juris Doctor degree. From March until May 2008 Mr. Ortíz served as Assistant Secretary of Internal Revenue at the Treasury. From April 2005 until March 2008 Mr. Ortíz was Assistant Secretary of the Treasury. Prior to working for the Commonwealth, from May 2001 until April 2005 Mr. Ortíz was Senior Treasurer of Pfizer Pharmaceuticals LLC. Prior to 2001 he worked at PricewaterhouseCoopers.

Armando A. Valdez was appointed Executive Director of the Commonwealth of Puerto Rico Office of Management and Budget in January, 2008. Before that he served as Advisor to the Governor from January 2005 to December 2007, as Executive Director of the Incoming Transition Committee from November 2004 to December 2004, and as Director of Intergovernmental Affairs to the Puerto Rico Federal Affairs Administration form June 2001 to

December 2003. He earned a Bachelor of Arts degree in Architecture from Yale University and a Masters degree in Government (thesis pending) from John Hopkins University.

Jorge Irizarry Herráns was appointed President of Government Development Bank ("GDB") on December 4, 2007. Mr. Irizarry served as Executive Vice President and Director of Financing of GDB from 2005 until his appointment as Acting President, and has over 30 years of experience in banking, investments and consulting, which he acquired while working at Chase Manhattan, Booz Allen Hamilton, Inc., Banco Mercantil, Banco de Ponce, PaineWebber, Inc., and Sandoval Associates. Mr. Irizarry has a Bachelor's degree in finance from New York University and holds a Masters Degree in Business Administration from Harvard Business School.

Political Trends

For many years there have been two major views in Puerto Rico with respect to Puerto Rico's relationship with the United States: one favoring commonwealth status, represented by the Popular Democratic Party, and the other favoring statehood, represented by the New Progressive Party. The following table shows the percentages of the total votes received by the gubernatorial candidates of the various parties in the last five elections. While the electoral choices of Puerto Rico's voters are not based solely on party preferences regarding Puerto Rico's relationship with the United States, candidates who support a continuing relationship between Puerto Rico and the United States have prevailed in elections for many years.

	1988	1992	1996	2000	2004
Popular Democratic Party	48.7%	45.9%	44.5%	48.6%	48.4%
New Progressive Party	45.8%	49.9%	51.1%	45.7%	48.2%
Puerto Rico Independence Party	5.4%	4.2%	3.8%	5.2%	2.7%
Others	0.1%	-	0.6%	0.5%	0.6%

With the results of the 2004 election, control of the executive branch continued under the Popular Democratic Party while the legislative branch is now controlled by the New Progressive Party. The composition of the Senate and House of Representatives by political party is as follows:

	Senate	House
Popular Democratic Party	9	18
New Progressive Party	17	32
Puerto Rico Independence Party	1	1
Total	27	51

The next general election (gubernatorial, municipal, and legislative) in Puerto Rico will be held in November 2008. Voter participation in Puerto Rico is substantially higher than in the United States, averaging 82% since 1972.

THE ECONOMY

General

The Commonwealth has established policies and programs directed principally at developing the manufacturing and services sectors of the economy and expanding and modernizing the Commonwealth's infrastructure. Domestic and foreign investments have been stimulated by selective tax exemptions, development loans, and other financial and tax incentives. Infrastructure expansion and modernization have been to a large extent financed by bonds and notes issued by the Commonwealth, its public corporations, and municipalities. Economic progress has been aided by significant increases in the levels of education and occupational skills of the population.

Puerto Rico's economy has expanded, on average, for more than two decades. Virtually every sector of the economy has participated in this expansion, and record levels of employment have been achieved. Factors contributing to this expansion include government-sponsored economic development programs, increases in the level of federal transfer payments, and the relatively low cost of borrowing. In some years, these factors were aided by a significant rise in construction investment driven by infrastructure projects, private investment, primarily in housing, and relatively low oil prices. In the three fiscal years after the previous recession, during fiscal year 2002, the economy expanded at a moderate annual rate of 2.2%. During fiscal year 2007, real gross national product decreased by 1.8%. This contraction continued into fiscal year 2008. The Planning Board expects a reduction of 2.1% of real gross national product for fiscal year 2008 and a recovery of 2.1% for fiscal year 2009. It is likely, given the continuing economic weakness in certain key economic variables, including employment and economic output, that the Planning Board will lower its prediction of economic growth for the fiscal year ending June 30, 2009.

Personal income, both aggregate and per capita, has increased consistently each fiscal year from 1985 to 2007. In fiscal year 2007, aggregate personal income was $53.1 billion ($44.4 billion in 2000 prices) and personal income per capita was $13,491 ($11,279 in 2000 prices).[1] Personal income includes transfer payments to individuals in Puerto Rico under various social programs. Total federal payments to Puerto Rico, which amount to around $12 billion annually and include transfers to local government entities and expenditures of federal agencies in Puerto Rico, in addition to federal transfer payments to individuals, are lower on a per capita basis in Puerto Rico than in any state of the United States. Eighty two percent (82%) of the transfer payments to individuals in fiscal year 2007 ($8.9 billion), represented entitlements for previously performed services or resulting from contributions to programs such as Social Security, Veterans' Benefits, Medicare, and U.S. Civil Service retirement pensions. Grants represent the remainder of the federal transfers to individuals, mostly concentrated in the Nutritional Assistance Program (Food Stamps) and Pell Grant (higher education) Scholarships.

Total average annual employment (as measured by the Department of Labor and Human Resources Household Employment Survey (the "Household Survey")) has also increased. From fiscal year 2000 to fiscal year 2008, annual employment increased 5.8% to 1,217,500.

---

[1] Different price deflators are used for gross national product and personal income statistics. The year 2000 is used as a basis for comparison because that is the year used by the U.S. Department of Commerce.

The dominant sectors of the Puerto Rico economy in terms of production and income are manufacturing and services. The manufacturing sector has undergone fundamental changes over the years as a result of increased emphasis on higher wage, high technology industries, such as pharmaceuticals, biotechnology, computers, microprocessors, professional and scientific instruments, and certain high technology machinery and equipment. The services sector, including finance, insurance, real estate, wholesale and retail trade, and tourism, also plays a major role in the economy. It ranks second to manufacturing in contribution to the gross domestic product and leads all sectors in providing employment.

The following table shows the gross national product for the five fiscal years ended June 30, 2007.

Commonwealth of Puerto Rico
Gross National Product
Fiscal Years Ended June 30,

	2003	**2004**	**2005**	**2006**	**2007**[(1)]
Gross national product – $ millions[(2)]	$47,479	$50,709	$53,752	$56,733	$58,712
Real gross national product – $ millions (2000 prices)	42,795	43,967	44,819	45,061	44,252
Annual percentage increase in real gross national product (2000 prices)	2.1%	2.7%	1.9%	0.5%	(1.8)%
U.S. annual percentage increase in real gross national product (2000 prices)	1.9%	4.0%	3.0%	3.1%	2.0%

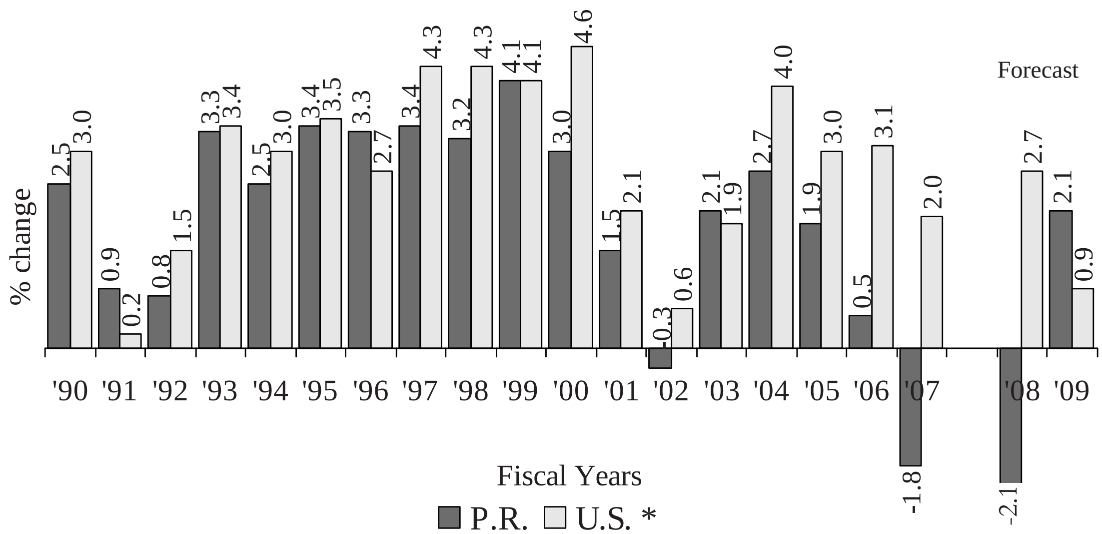
(1) Preliminary.
(2) In current dollars.

Sources: Puerto Rico Planning Board and Global Insight Inc.

The economy of Puerto Rico is closely linked to the United States economy, as most of the external factors that affect the Puerto Rico economy (other than the price of oil) are determined by the policies and performance of the mainland economy. These external factors include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the rate of inflation, and tourist expenditures. During fiscal year 2007 (from July 1, 2006 to June 30, 2007) approximately 77% of Puerto Rico's exports went to the United States mainland, which was also the source of approximately 50% of Puerto Rico's imports.

The following graph compares the growth rate of real gross national product for the Puerto Rico and United States economies since fiscal year 1990, and the forecast of the growth rate for fiscal years 2008 and 2009.

REAL GNP GROWTH RATE



* Global Insight 3/08.

Since the 1950s, the Puerto Rico Planning Board (the "Planning Board") has prepared a complete set of macroeconomic measures like those prepared for the United States by the Bureau of Economic Analysis ("BEA") of the Department of Commerce, as part of the National Income and Product Accounts ("NIPA"). In contrast with BEA, which computes the economic accounts on a quarterly basis, the Planning Board computes Puerto Rico's NIPA on an annual basis. Like BEA, the Planning Board revises its statistics on a regular basis. The Planning Board classifies its statistics as preliminary until they are revised and made final in conjunction with the release of new data each year. Thus, all macroeconomic accounts for fiscal year 2007 shown in this report are preliminary until the revised figures are released and the forecasts for fiscal years 2008 and 2009 revised.

Forecast for Fiscal Year 2008

The Planning Board's gross national product forecast for fiscal year 2008, which was released in March 2008, projected a decline of 2.1% in constant dollars, or an increase of 3.4% in current dollars. Personal income is expected to increase by 0.8% in real terms, or 4.3% in nominal terms (see footnote 1 on page I-4). The Planning Board expects real growth to return in fiscal year 2009, at 2.1%, or 7.1% in current dollars. It is likely, given the continuing economic weakness in certain key economic variables, including employment and economic output, that the Planning Board will lower its prediction of economic growth for the fiscal year ending June 30, 2009. The major factors affecting the economy at this point are, among others, the continued increase of oil prices, the slowdown of U.S. economic activity, and the continuing economic uncertainty generated by the Commonwealth's fiscal crisis. These factors and the effects on economic activity of the implementation of the new sales tax are persuading consumers to adjust their behavior to the new economic conditions.

According to the Household Survey, total employment for fiscal year 2008 averaged 1,217,500, a decrease of 3.6% compared to 1,262,900 for fiscal year 2007. At the same time, the unemployment rate for fiscal year 2008 was 11.0%, an increase from 10.4% for fiscal year 2007.

Fiscal Year 2007

The Planning Board's preliminary reports on the performance of the Puerto Rico economy for fiscal year 2007 indicate that real gross national product decreased 1.8% (3.5% in current dollars) over fiscal year 2006. Nominal gross national product was $58.7 billion in fiscal year 2007 ($44.3 billion in 2000 prices), compared to $56.7 billion in fiscal year 2006 ($45.1 billion in 2000 prices). Aggregate personal income increased from $51.1 billion in fiscal year 2006 ($44.0 billion in 2000 prices) to $53.9 billion in fiscal year 2007 ($44.4 billion in 2000 prices), and personal income per capita increased from $13,033 in fiscal year 2006 ($11,229 in 2000 prices), to $13,491 in fiscal year 2007 ($11,279 in 2000 prices).

According to the Household Survey, total employment for fiscal year 2007 averaged 1,262,900, an increase of 0.8% compared to 1,253,400 for fiscal year 2006. The driving force behind total employment was self-employment. The unemployment rate for fiscal year 2007 was 10.4%, a decrease from 11.7% for fiscal year 2006. As in the past, the economy of Puerto Rico followed the general performance and trends of the United States economy, although at a lower rate of growth.

Among the variables contributing to the Planning Board's downward revision in the forecast were the current effect of persistent high levels of oil prices, and the current slowdown of the United States economy. Moreover, the continuing weakness of local construction investment has aggravated the current situation. The persistent high level of the price of oil and its derivatives (such as gasoline) has served to reduce the income available for other purchases and, thereby, negatively affected domestic demand. Due to the Commonwealth's dependence on oil for power generation and gasoline in spite of its recent improvements in power production diversification, the high level of oil prices is expected to account for an increased outflow of local income in fiscal year 2008. The current financial difficulties associated with the subprime mortgage crisis have resulted in lowering of short-term interest rates. This could help alleviate the situation of the construction sector, which historically has been a major contributor to economic growth. The implementation of the tax reform legislation discussed below may reduce net disposable income even after giving effect to certain income tax reductions provided in the tax reform legislation. For a discussion of the Commonwealth's fiscal difficulties and the recently enacted tax reform, see "Tax Reform" under Puerto Rico Taxes, Other Revenues, and Expenditures.

Fiscal Year 2006

The Planning Board's reports of the performance of the Puerto Rico economy during fiscal year 2006 indicate that the economy (as registered by real gross national product) grew by 0.5%. Nominal gross national product was $56.7 billion ($45.1 billion in 2000 prices), compared to $53.8 billion in fiscal year 2005 ($44.8 billion in 2000 prices). This represents an increase in nominal gross national product of 5.5%. Aggregate personal income increased from $48.8 billion ($44.0 billion in 2000 prices) to $51.1 billion in fiscal year 2006 ($44.0 billion in

2000 prices), and personal income per capita increased from $12,507 in fiscal year 2005 ($11,267 in 2000 prices), to $13,033 in fiscal year 2006 ($11,229 in 2000 prices).

According to the Household Survey, total employment for fiscal year 2006 averaged 1,253,400, an increase of 1.3% compared to 1,237,600 for fiscal year 2005. The unemployment rate for fiscal year 2006 was 11.7%, an increase from 10.6% for fiscal year 2005, due to the partial government shutdown in May 2006 that resulted in the two week furlough of many government employees. As in the past, the economy of Puerto Rico followed the performance and general trends of the United States economy but did not reach the level of U.S. real economic growth.

Economic Development Program

The Commonwealth's economic development program is now focused on initiatives aimed at producing more diversified and sustainable economic development. The six principal elements of these initiatives, as expressed in the Governor's Economic Development and Government Transformation Plan for Puerto Rico, are: (i) developing world-class infrastructure, while encouraging private investment with innovative financial models and agile, effective evaluation processes; (ii) accelerating Puerto Rico's entry into the knowledge economy by creating a center of excellence in biotechnology, engineering and computing; (iii) promoting local enterprise and supporting local businesses (in Spanish, Apoyo al de Aquí) by providing innovative financing alternatives and access to domestic and foreign markets; (iv) transforming the tourist industry into a vehicle for Puerto Rico's economic development; (v) diversifying energy-generating sources to reduce dependence on petroleum by half; and (vi) transforming Puerto Rico's government, without layoffs or privatization, through effective agency consolidation and decentralization of functions while offering first-class service to all citizens in a sensible, effective and agile manner that contributes to Puerto Rico's socio-economic development.

The Commonwealth has formulated a strategic plan to increase its competitiveness in knowledge-based economic sectors, such as research and development of science and technology products. Four major components of this strategic plan are: (i) building on the strong presence in Puerto Rico of multinational companies in the science and technology sectors; (ii) building on Puerto Rico's skilled workforce to promote the expansion of research and development facilities by companies currently operating in Puerto Rico; (iii) attracting new companies in such sectors; and (iv) providing incentives for companies and entrepreneurs to engage in the process of innovation and commercialization of new products and to establish research and development facilities in Puerto Rico. The last initiative includes the creation of the Puerto Rico Science & Technology Trust, a government-sponsored trust (currently capitalized at $4.9 million and expected to grow to $25 million in three years), that will provide grants and financing to companies, entrepreneurs, and universities that engage in these activities. As part of this plan, construction has begun on a biotechnology plant in Mayagüez and a molecular sciences building on the main campus of the University of Puerto Rico in Río Piedras. Additionally, the Department of Transportation has transferred land to the University of Puerto Rico for the construction of a cancer center.

As part of this strategic plan, the Commonwealth is actively pursuing local participation in the aerospace industry, including engineering design services and the outsourcing of business activities. Also, recently Industrial Development Company ("PRIDCO") began a program to improve local entrepreneurial capacity by evaluating local businesses for worldwide best practices, and the Economic Development Bank started a new venture capital program offering financing to entrepreneurs that present projects with great potential for commercialization.

The Commonwealth is also providing incentives to promote the establishment of distribution and call centers, the acquisition and development of patents, and the development of a local entrepreneurial class. Distribution and call centers located in the Commonwealth will benefit from a preferential tax rate of 4% if they offer services to Latin America and 2% if they offer hemisphere or worldwide services. The Commonwealth has decided to focus on this type of industry because it is labor intensive, presents no environmental concerns, and is generally able to start operations quickly. Over two dozen call centers have recently been established with employment of over 2,500 persons.

With respect to the acquisition and development of patents, under newly enacted legislation, the Secretary of the Treasury may (i) negotiate the payment of taxes on patent royalties; and (ii) reduce the tax rate on patent royalties to a rate as low as 2%. These incentives are in addition to those already enacted for research and development carried out in the Commonwealth. To further develop a local entrepreneurial class, the Commonwealth has enacted legislation providing local entrepreneurs with the following benefits: (i) tax incentives to retailers that use their distribution channels to sell products made in Puerto Rico in other jurisdictions; (ii) requiring at least 15% of products and services purchased by government agencies to be locally manufactured or provided; and (iii) the use of government-sponsored financing, marketing and/or training to promote the production of economically feasible products or services for Puerto Rico markets.

Puerto Rico Tax Incentives

One of the benefits enjoyed by the Commonwealth is that corporations operating in Puerto Rico (other than corporations organized in the United States with a local branch) and individuals residing in Puerto Rico generally are not subject to federal income taxes on income derived in Puerto Rico. This enables the Commonwealth to utilize local tax legislation as a tool for stimulating economic development, and it has done so for many years. See "Tax Incentives" below.

In this regard, the Commonwealth enacted legislation extending certain benefits of its most recent tax incentives law, Act No. 135 of December 2, 1997, as amended (the "1998 Tax Incentives Act"), to all eligible businesses operating under previous tax incentives laws. These incentives were initially scheduled to be available until December 31, 2007, but were extended until June of 2008 (although tax incentive concessions granted thereunder will continue to be in effect until their respective dates of expiration). On May 28, 2008 the Commonwealth enacted a new tax incentives law, Act No. 73 (the "Economic Incentives Act").

The Economic Incentives Act streamlines the process for obtaining tax incentives and provides recipients with certainty as to the amount of benefits they will receive over time. The

Economic Incentive Act expands the definition of manufacturing to include cluster and supply chain concepts, addresses issues of cost competitiveness, and simplifies the applicable rules. The tax structure established by the Economic Incentives Act generally has a 4% income tax rate and a 12% withholding tax rate for royalties. An alternative structure has an 8% income tax rate and a 2% withholding tax on royalties. For existing businesses with tax rates between 2% and 4%, the Secretary of Economic Development has the discretion to grant the same tax benefits if doing so is considered to be in the best interests of Puerto Rico's economy. Income tax rates may be reduced by an additional 0.5% for projects located in low-or mid-economic development areas. Additional exceptions to the general tax structure exist for pioneering activities, local firms and small businesses. Pioneering activities may have a 1% income tax rate, or no income taxes if the research and development activity is located completely within Puerto Rico. For local firms, the tax rate is 3% and for small businesses the tax rate is 1%.

A variety of credits are available under the Economic Incentives Act, including: for the purchase of products manufactured in Puerto Rico; for job creation; for investment in research and development; for investment in energy generation equipment; to reduce the cost of energy; to transfer technology; and for investors who acquire exempt operations in the process of shutting down. There are also investment credits for projects classified as strategic projects. Some of these credits can be carried forward and others can be sold.

In December 2006, two laws were approved that provide additional tax incentives to foster economic development in Puerto Rico. Act No. 289 of December 26, 2006 amended the 1994 Puerto Rico tax code in order to facilitate the creation of local Real Estate Investment Trusts (REITs). A REIT is a corporation, usually publicly traded, that manages a portfolio of real estate to earn profits for shareholders. Under Act No. 289, a special tax rate of 10% applies to the income from this type of investment. The creation of REITs is expected to encourage investment in residential, commercial and industrial properties and hotels, and will contribute to the development of a local capital market.

Act No. 287 of December 26, 2006 created a new financing conduit for PRIDCO-sponsored economic development activity, to be known as the Puerto Rico Investment Development Initiative. The interest paid on debt securities issued by companies operating under the Puerto Rico Industrial Incentives Act of 1998 is exempt from Puerto Rico income taxes for *bona fide* residents of Puerto Rico and local corporations. The proceeds of such debt can be used for general business purposes, such as raw materials and machinery acquisition, construction, general business expenses, intellectual property and research and development, among others, but 80% of the proceeds must be used within Puerto Rico by the benefited company.

Reduction of the Costs of Doing Business

The Commonwealth believes that to make Puerto Rico more competitive and foster investment it needs to reduce the cost of doing business in Puerto Rico. In order to accomplish this, the Commonwealth proposes to (i) promote the creation of more cogeneration power plants to diversify energy fuel sources and reduce oil imports for electric power generation; (ii) streamline the permitting process to accelerate and reduce the cost of investment in Puerto Rico; and (iii) create a multi-agency task force to expedite critical projects. The Commonwealth has also implemented additional initiatives to restructure certain government agencies in order to improve the services offered by these agencies and provide such services in a more efficient manner. Both PRIDCO and Tourism Company have completed restructurings resulting in their being able to respond more quickly to the needs of their constituents while shedding over 500 employment positions.

The Commonwealth is in the process of diversifying its energy fuel sources. Two cogeneration power plants, one of which is fueled by coal and the other by liquefied natural gas, have reduced Puerto Rico's dependence on oil imports for the generation of electricity by approximately 25%, from 99% to 74%. Currently, as part of the Electric Power Authority's capital improvement plan, the Authority is considering building an additional cogeneration power plant fueled by liquefied natural gas in the municipality of Mayagüez.

The Department of Economic Development and Commerce initiated a reengineering of the Commonwealth's investment project evaluation process in which all branches of the Commonwealth government participated. The first phase, completed in December 2006, evaluated and developed the model. Currently, the project is in second phase, which consists of testing a virtual permitting system in 15 municipalities. Simultaneously, a group of participants are reviewing the laws, bylaws and management of each agency to streamline the evaluation process.

Federal Tax Incentives

In connection with the phase-out of Sections 30A and 936 of the U.S. Internal Revenue Code of 1986, as amended (the "U.S. Code") (see "Tax Incentives – Incentives under the U.S. Code" below), the United States Senate requested the Joint Commission on Taxation ("JCT") and the United States Government Accountability Office ("GAO") to study the economic impact of this phase-out and present recommendations on alternative tax incentives for U.S.-based companies operating in Puerto Rico. In anticipation of the final phase-out of Sections 30A and 936 of the U.S. Code, most U.S.-based companies operating under Sections 30A and 936 converted from United States corporations to Controlled Foreign Corporations ("CFCs"), thus lessening the impact of the phase-out of those sections on their operations.

In May 2006, the GAO published its study titled "Fiscal Relations with the Federal Government and Economic Trends during the phase-out of the Possessions Tax Credit." The GAO study found that Puerto Rico's per capita gross domestic product and gross national product were significantly lower compared to United States averages, and the absolute gap between the per capita gross national product of Puerto Rico residents and that of United States residents has increased. The GAO study further found that, although the value-added by United States companies claiming the possessions tax credit decreased by about two-thirds during the period 1993-2003, much of the decline was offset by growth in other corporations, such as pharmaceuticals. Finally, the GAO study determined that although residents of Puerto Rico pay considerably less total tax per capita than residents of the United States, they pay approximately the same percentage of their personal income in taxes. The GAO study, which is informative in nature, is intended to help the United States Congress decide which economic development initiatives will best suit Puerto Rico's current situation.

In June 2006, the JCT published its pamphlet titled "An Overview of the Special Tax Rules related to Puerto Rico and an Analysis of the Tax and Economic Policy Implications of Recent Legislative Options" (the "JCT Report"). The JCT Report provides an overview of the tax and non-tax rules applicable to United States possessions, the special tax rules applicable to Puerto Rico and an economic analysis of such special tax rules. The JCT Report also presents certain legislative options and specific proposals that have been advocated by various parties in order to stimulate economic growth in Puerto Rico. Although these legislative options and specific proposals are not recommendations, the JCT Report does state that federal and Commonwealth tax policy must be coordinated in order to design and implement new tax proposals aimed at enhancing development in Puerto Rico by targeting problems unique to Puerto Rico, instead of problems common to the United States and Puerto Rico, which proposals are likely to induce business to relocate from the United State to Puerto Rico.

The Commonwealth is seeking the extension of additional sections of the U.S. Code that provide a dividends received deduction for a percentage of profits generated in Puerto Rico by controlled foreign corporations, as well as deductions that would encourage investments in research and development activities.

Employment and Unemployment

The number of persons employed in Puerto Rico during fiscal year 2008 averaged 1,217,500, a 3.6% decrease from 1,262,900 in fiscal year 2007. Unemployment is about twice the United States average.

The following table presents annual statistics of employment and unemployment for fiscal year 2004 through fiscal year 2008. These employment figures are based on the Household Survey, which includes self-employed individuals, instead of the non-farm, payroll employment survey (the "Payroll Survey"), which does not. The number of self-employed individuals represents around 17% of civilian employment in Puerto Rico, more than double the level in the United States.

Commonwealth of Puerto Rico
Employment and Unemployment(1)
(persons age 16 and over)
(in thousands)

Fiscal Years Ended June 30,	Labor Force	Employed	Unemployed	Unemployment Rate(2)
		(Annual Average)		
2004	1,360	1,206	155	11.4%
2005	1,385	1,238	147	10.6
2006	1,420	1,253	167	11.7
2007	1,410	1,263	147	10.4
2008	1,368	1,218	151	11.0

(1) Totals may not add due to rounding.
(2) Unemployed as percentage of labor force.

Source: Department of Labor and Human Resources – Household Survey

Economic Performance by Sector

From fiscal year 2003 to fiscal year 2007, the manufacturing and services sectors generated the largest portion of gross domestic product. The three sectors of the economy that provide the most employment are manufacturing, services and government.

The following table presents annual statistics of gross domestic product by sector and gross national product for the five fiscal years ended June 30, 2003 through 2007.

Commonwealth of Puerto Rico
Gross Domestic Product by Sector and Gross National Product
(in millions at current prices)

	Fiscal Years Ended June 30,				
	2003	**2004**	**2005**	**2006**	**2007**(1)
Manufacturing	$31,532	$33,267	$34,534	$36,547	$36,717
Services(2)	28,919	30,476	32,449	33,948	35,925
Government(3)	6,948	7,389	8,150	8,424	8,586
Transportation, communication and public utilities	5,178	5,343	5,309	5,701	5,971
Agriculture, forestry and fisheries	333	414	375	385	441
Construction(4)	1,772	1,905	1,848	1,807	1,875
Statistical discrepancy	146	415	144	131	186
Total gross domestic product(5)	$74,827	$79,209	$82,809	$86,943	$89,701
Less: net payment abroad	(27,348)	(28,501)	(29,056)	(30,210)	(30,989)
Total gross national product(5)	$47,479	$50,709	$53,753	$56,733	$58,712

(1) Preliminary.
(2) Includes wholesale and retail trade, finance, insurance and real estate, tourism, and other services.
(3) Includes the Commonwealth, its municipalities and certain public corporations, and the federal government. Excludes certain other public corporations, like the Electric Power Authority and the Aqueduct and Sewer Authority whose activities are included under Services in the table.
(4) Includes mining.
(5) Totals may not add due to rounding.

Source: Planning Board

The data for employment by sector or industries presented here, like in the United States, are based on the Payroll Survey, which is designed to measure employment by sector. The Payroll Survey excludes agricultural employment and self-employed persons.

The following table presents annual statistics of average employment based on the North American Industry Classification System (NAICS) for fiscal years 2004 to 2008.

Commonwealth of Puerto Rico
Non-Farm, Payroll Employment by Economic Sector[(1)]
(persons age 16 and over)

	Fiscal Years Ended June 30,				
	2004	**2005**	**2006**	**2007**	**2008[(2)]**
Natural Resources and Construction	69,300	68,233	67,442	67,367	66,708
Manufacturing					
Durable Goods	48,808	48,067	46,350	45,400	43,892
Non-Durable Goods	69,633	69,250	66,233	62,367	60,042
Sub Total	118,441	117,317	112,583	107,767	103,934
Trade, Transportation, Warehouse & Utilities					
Wholesale Trade	33,300	33,717	33,992	33,333	33,283
Retail Trade	132,008	136,192	137,358	134,108	131,317
Transportation, Warehouse & Utilities	17,042	17,617	17,433	16,858	16,008
Sub Total	182,350	187,526	188,783	184,299	180,608
Information	21,917	22,608	22,675	22,667	22,225
Finance	46,850	48,633	49,767	49,142	48,408
Professional & Business	101,900	103,767	106,517	108,608	104,800
Educational & Health	98,108	99,967	103,650	104,917	104,608
Leisure & Hospitality	70,317	72,592	74,767	73,675	73,808
Other Services	20,650	21,258	20,567	18,542	18,125
Government	303,408	307,825	302,492	298,125	296,167
Total Non-Farm	1,033,242	1,049,725	1,049,242	1,035,108	1,019,392

(1) The figures presented in this table are based on the Payroll Survey prepared by the Bureau of Labor Statistics of the Department of Labor and Human Resources. There are numerous conceptual and methodological differences between the Household Survey and the Payroll Survey. The Payroll Survey reflects information collected from payroll records of a sample of business establishments, while the Household Survey is based on responses to a series of questions by persons in a sample of households. The Payroll Survey excludes the self-employed and agricultural employment. Totals may not add due to rounding.
(2) Preliminary.

Source: Department of Labor and Human Resources, Current Employment Statistics Survey (Establishment Survey – NAICS Codes)

Manufacturing

Manufacturing is the largest sector of the Puerto Rico economy in terms of gross domestic product. The Planning Board figures show that in fiscal year 2007 manufacturing generated $36.7 billion, or 40.9%, of gross domestic product. During fiscal year 2008, payroll employment for the manufacturing sector was 103,900, a decrease of 3.6% compared with fiscal year 2007. Most of the island's manufacturing output is shipped to the United States mainland, which is also the principal source of semi-finished manufactured articles on which further manufacturing operations are performed in Puerto Rico. The United States minimum wage laws are applicable in Puerto Rico. For fiscal year 2008, the average hourly manufacturing wage rate in Puerto Rico was approximately 68.5% of the average mainland United States rate.

Manufacturing in Puerto Rico is now more diversified than during the earlier phases of its industrial development and includes several industries less prone to business cycles. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor. This gradual shift in emphasis is best exemplified by large investments over the last decade in the pharmaceutical, scientific instruments, computers and electrical products industries in Puerto Rico. One of the factors encouraging the development of the manufacturing sector has been the tax incentives offered by the federal and Puerto Rico governments. Federal legislation enacted in 1996, however, which amended Section 936 of the U.S. Code, phased out these federal tax incentives during a ten-year period that recently ended. This change has had a long-term impact on local manufacturing activity. See “Tax Incentives – Incentives under the U.S. Code” under *The Economy*.

The following table sets forth gross domestic product by manufacturing sector for the five fiscal years ended June 30, 2003 through June 30, 2007.

Commonwealth of Puerto Rico
Gross Domestic Product by Manufacturing Sector
(in millions at current prices)

	Fiscal Years Ended June 30,				
	2003	**2004**	**2005**	**2006**	**2007**
Pharmaceuticals	$18,998	$19,814	$20,705	$21,837	$21,511
Machinery and metal products:					
Machinery, except electrical	3,507	3,372	3,307	3,215	3,210
Electrical machinery	1,771	1,818	1,904	1,852	1,811
Professional and scientific instruments	2,981	3,540	3,698	4,157	4,364
Other machinery and metal products	288	274	282	285	293
Food products	1,903	2,202	2,312	2,959	3,146
Other chemical and allied products	502	591	613	624	375
Apparel	353	344	325	228	222
Other[1]	1,231	1,312	1,387	1,391	1,786
Total gross domestic product of manufacturing sector[2]	$31,532	$33,267	$34,534	$36,547	$36,717

(1) Includes petroleum products; petrochemicals; tobacco products; stone, clay and glass products; textiles and others.
(2) Totals may not add due to rounding.

Source: Planning Board

The following table presents annual statistics of average manufacturing employment by industry based on the North American Industry Classification System (NAICS) for fiscal years 2004 to 2008.

Commonwealth of Puerto Rico
Non-Farm Payroll Manufacturing Employment by Industry Group*
(persons age 16 years and over)

	Fiscal Years Ended June 30,				
Industry Group	**2004**	**2005**	**2006**	**2007**	**2008(1)**
Durable Goods					
Nonmetallic Mineral Products Manufacturing	4,708	4,467	4,100	3,758	3,517
Cement and Concrete Products Manufacturing	3,850	3,750	3,533	3,225	3,108
Fabricated Metal Products	6,483	6,442	5,775	5,650	5,358
Computer and Electronic	10,575	10,667	10,808	10,133	9,042
Electrical Equipment	7,750	7,650	6,842	6,625	6,625
Electrical Equipment Manufacturing	4,933	4,975	4,700	4,617	4,683
Miscellaneous Manufacturing	11,100	11,158	11,258	12,333	12,725
Medical Equipment and Supplies Manufacturing	11,067	10,467	10,533	11,617	12,108
Other Durable Goods Manufacturing	8,192	7,683	7,567	6,901	6,625
Total – Durable Goods	48,808	48,067	46,350	45,400	43,892
Non-Durable Goods					
Food Manufacturing	13,242	13,050	12,650	12,225	12,175
Beverage and Tobacco Products Manufacturing	3,042	3,175	3,392	3,267	3,325
Apparel Manufacturing	8,533	8,875	8,258	7,625	8,800
Cut and Sew Apparel Manufacturing	8,533	8,850	8,017	6,992	7,925
Chemical Manufacturing	32,367	32,883	32,317	30,350	26,675
Pharmaceutical and Medicine Manufacturing	28,158	28,567	28,017	26,267	22,892
Plastics and Rubber Products	3,217	2,750	2,325	2,200	2,033
Plastics Product Manufacturing	2,917	2,258	2,133	2,025	1,858
Other Non-Durable Goods Manufacturing	9,232	8,517	7,291	6,700	7,034
Total – Non-Durable Goods	69,633	69,250	66,233	62,367	60,042
Total Manufacturing Employment	118,442	117,317	112,583	107,767	103,933

* Totals may not add due to rounding.
(1) Preliminary.

Source: Department of Labor and Human Resources, Current Employment Statistic Survey (Establishment Survey – NAICS Codes)

Total employment in the manufacturing sector decreased by 14,509 from fiscal year 2004 to fiscal year 2008. Manufacturing employment had been declining during the past decade, but the decline accelerated during fiscal years 2002 and 2003, falling -10.6% and -4.8%, respectively. After that, manufacturing employment seemed to stabilize around 118,000 jobs, but the deceleration reappeared in fiscal year 2006 with the sector experiencing another significant drop of -4.0%. For fiscal years 2007 and 2008, manufacturing employment decreased by -4.3% and -3.6%, respectively. During fiscal year 2008 the manufacturing sector lost around 3,800 jobs. There are several reasons which explain this sector's job shrinkage: the end of the phase-out of Section 936, the net loss of patents on certain pharmaceutical products, the escalation of manufacturing production costs (particularly labor and electricity), and the increased use of job outsourcing. Puerto Rico's manufacturing sector is facing increased international competition, and new ideas and initiatives are necessary to improve this sector.

Leading United States and Foreign Companies with Manufacturing Operations in Puerto Rico[1]

Employment 2,500 and over	**Product**
Baxter International, Inc.	Medical Devices
Johnson & Johnson	Pharmaceuticals
Medtronic Europe SA	Medical Devices
Pfizer, Inc.	Pharmaceuticals

Employment 1,000 to 2,499	**Product**
Abbott Laboratories	Pharmaceuticals
Altadis	Cigars
Amgen, Inc.	Pharmaceuticals
Bristol-Myers Squibb Co.	Pharmaceuticals
Coopervision Inc.	Ophthalmic Products
Eaton Corporation	Electronic Instruments
Edwards Lifesciences LLC	Surgical Instruments
Eli Lilly and Company	Pharmaceuticals
General Electric Industrial Systems	Electronic Instruments
Glaxo Smithkline	Pharmaceuticals
Hewlett-Packard Co.	Computers
Merck & Co., Inc.	Pharmaceuticals
Propper International, Inc.	Apparel
Tyco International	Surgical Products
Wyeth	Pharmaceuticals

Employment 500 to 999	**Product**
Astra Zeneca PLC	Pharmaceuticals
Atento Teleservicios	Communications
Becton-Dickinson & Co.	Surgical Instruments
Cardinal Health, Inc.	Surgical Instruments
Centennial Communication	Wireless Communications
Eagle Industries Inc.	Apparel
Grupo Gloria	Food
Guidant Corp.	Medical Instruments
Hamilton Sundstrand Corp.	Electrical Instruments
Hubbell Incorporated	Electrical Instruments
Ingersoll-Rand Co.	Electrical Instruments
Nypro International	Electronics
Patheon Inc.	Pharmaceuticals
Procter & Gamble Co.	Pharmaceuticals
Sara Lee Corp.	Apparel
Sitnasuak Native Corporation	Apparel
St. Jude Medical, Inc.	Medical Devices
Stryker Corp.	Surgical Instruments
Unilever PLC	Consumer Products
Zimmer Holdings, Inc.	Pharmaceuticals

Employment 200 to 499	**Product**
Bacardí Limited	Food
B. Braun Medical, Inc.	Medical Devices
Biovail Corporation International	Pharmaceuticals
Bumble Bee Seafoods	Food
Carolina Underwear Co.	Apparel
Checkpoint Systems, Inc.	Electronic Instruments
Coca Cola Company	Food
C.R. Bard, Inc.	Medical Devices
Curtis Instruments Inc.	Electrical Instruments
Davis Creek Managing Partners	Metal Products
E.I. DuPont de Nemours & Co.	Chemicals
Essilor International	Medical Devices
F. Hoffman-La Roche	Medical Devices
Honeywell Aerospace	Engineering Consulting Services
Iversionistas Foraneos	Electronic Instruments
Legacy Pharmaceuticals International	Pharmaceuticals
Loctite Corporation	Chemicals
Lutron Electronics Co. Inc.	Electronic Instruments
Mylan Laboratories, Inc.	Pharmaceuticals
Novartis	Pharmaceuticals
PepsiCo, Inc.	Food
Pratt & Whitney	Software
Sears Roebuck & Company	Electronic Products
Standard Motor Products, Inc.	Motor Vehicle Parts
Symmetricom Inc.	Electronic Equipment
Thomas & Betts Corporation	Electrical Instruments
Warner Chilcott PLC	Pharmaceuticals
West Pharmaceutical Serivces	Pharmaceuticals
Winston-Salem Industries for the Blind, Inc.	Apparel

[1] Based on the last employment figures reported by each company to PRIDCO.

Source: PRIDCO; Economic Analysis and Strategic Planning Area.

Services

Puerto Rico has experienced significant growth in the services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism and other services, in terms of both income and employment over the past decade, showing a favorable trend as compared with certain other industrialized economies. During the period between fiscal years 2003 and 2007, the gross domestic product in this sector, in nominal terms, increased at an average annual rate of 5.4%, while payroll employment in this sector increased at an average annual rate of 1.7%. In the Puerto Rico labor market, self-employment, which is not accounted for in the Payroll Survey, represents approximately 17% of total employment according to the Household Survey. Most of the self-employment is concentrated in the service and construction sectors. The development of the services sector has been positively affected by demand generated by other sectors of the economy, such as manufacturing, construction and agriculture. The services sector in Puerto Rico has a diversified base.

The high degree of knowledge, skills, and expertise in professional and technical services available in Puerto Rico places the island in a favorable competitive position with respect to Latin America and other trading countries throughout the world.

The services sector ranks second to manufacturing in its contribution to gross domestic product, and it is the sector with the greatest employment. In fiscal year 2007, services generated $35.9 billion of gross domestic product, or 40% of the total. Services employment grew from 523,691 in fiscal year 2003 to 562,949 in fiscal year 2007 (representing 54.5% of total, non-farm, payroll employment). This represents a cumulative increase of 7.5% during such period. Wholesale and retail trade, finance, insurance and real estate experienced significant growth in fiscal years 2003 to 2007, as measured by gross domestic product. From fiscal year 2003 to 2007, gross domestic product increased in wholesale and retail trade from $9.2 billion to $11.1 billion, and in finance, insurance, and real estate from $12.5 billion to $16.3 billion. There are sixteen commercial banks and trust companies currently operating in Puerto Rico. Total assets of these institutions as of December 31, 2007 were $113.9 billion. As of December 31, 2007, there were approximately thirty-five international banking entities operating in Puerto Rico licensed to conduct offshore banking transactions with total assets of $75.8 billion.

The following tables set forth gross domestic product for fiscal years 2003 to 2007 and employment for the services sector for fiscal years 2004 to 2008.

Commonwealth of Puerto Rico
Gross Domestic Product by Service Sector*
(in millions at current prices)

	Fiscal Years Ended June 30,				
	2003	**2004**	**2005**	**2006**	**2007**[1]
Wholesale and retail trade	$ 9,150	$ 9,802	$10,217	$10,709	$11,061
Finance, insurance and real estate	12,508	13,029	14,267	14,998	16,336
Other services[2]	7,261	7,646	7,965	8,241	8,529
Total	$28,919	$30,476	$32,449	$33,948	$35,925

* Totals may not add due to rounding.
(1) Preliminary.
(2) Includes tourism.

Source: Planning Board.

Commonwealth of Puerto Rico
Non-Farm Payroll Employment by Services Sector*
(thousands of persons age 16 and over)

	Fiscal Years Ended June 30,				
	2004	**2005**	**2006**	**2007**	**2008**[1]
Wholesale Trade	33,300	33,717	33,992	33,333	33,283
Retail Trade	132,008	136,192	137,358	134,108	131,317
Transportation, Warehouse & Utilities	17,042	17,617	17,433	16,858	16,008
Trade, Transportation, Warehouse & Utilities	182,350	187,525	188,783	184,300	180,608
Information	21,917	22,608	22,675	22,667	22,225
Finance	46,850	48,633	49,767	49,142	48,408
Professional and Business	101,900	103,767	106,517	108,608	104,800
Educational & Health	98,108	99,967	103,650	104,917	104,608
Leisure & Hospitality	70,317	72,592	74,767	73,675	73,808
Other Services	20,650	21,258	20,567	18,542	18,125
Total	542,092	556,351	566,726	561,850	552,582

* Totals may not add due to rounding.
(1) Preliminary.

Source: Department of Labor and Human Resources, Benchmark on Employment, Hours and Earnings

Hotels and Related Services – Tourism

During fiscal year 2006, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists, was 1,922,500, an increase of 3.8% over the number of persons registered during the same period in fiscal year 2005. The number of non-resident tourists registered in tourist hotels during fiscal year 2006 increased 4.0% compared to fiscal year 2005. Tourist hotel rooms available during fiscal year 2006 increased 3.9% compared to fiscal year 2005. The average occupancy rate in tourist hotels during fiscal years 2005 and 2006 was 70.8%.

During fiscal year 2007, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists, was 1,798,400, a decrease of 6.5% over the number of persons registered during fiscal year 2006. The average occupancy rate in tourist hotels during fiscal year 2007 was 71.5%, compared to 70.8% in fiscal year 2006. The average number of rooms available in tourist hotels decreased 6.4% from fiscal year 2006 to fiscal year 2007 as the completion of regular maintenance and rehabilitation of rooms (that normally results in a certain number of rooms being unavailable at any time) took longer to complete than in the past.

The number of persons registered in tourist hotels during the first eleven months of fiscal year 2008, was 1,576,900, a decrease of 12.3% over the number of persons registered during the same period of fiscal year 2007. The average occupancy rate in tourist hotels during the first eleven months of fiscal year 2008 was 69.7%, compared to 71.3% in the period for fiscal year 2007. During the first eleven months of fiscal year 2008, the average number of rooms available in tourist hotels increased 2.3% compared with the same period in fiscal year 2007.

San Juan is the largest homeport for cruise ships in the Caribbean and one of the largest homeports for cruise ships in the world.

The following table presents data relating to visitors to Puerto Rico and tourist expenditures for the five fiscal years ended June 30, 2007.

Commonwealth of Puerto Rico
Tourism Data[1]
Number of Visitors

Fiscal Years Ended June 30,	Tourist Hotels[2]	Cruise Ship	Other[3]	Total	Total Visitors' Expenditures (in millions)
2003	$1,239,200	$1,163,900	$1,999,200	$4,402,300	$2,676.6
2004	1,307,000	1,348,200	2,234,000	4,889,200	3,024.0
2005	1,361,640	1,386,925	2,324,275	5,072,840	3,238.6
2006	1,424,170	1,300,120	2,297,840	5,022,130	3,369.3
2007[4]	1,353,380	1,375,430	2,333,600	5,062,410	3,143.9

(1) Only includes information about non-resident tourists registering in tourist hotels. They are counted once even if registered in more than one hotel.
(2) Includes visitors in guesthouses.
(3) Includes visitors in homes of relatives, friends, and in hotel apartments.
(4) Preliminary.

Sources: Puerto Rico Tourism Company and the Planning Board

The Commonwealth, through the Convention Center District Authority, has completed the development of the largest convention center in the Caribbean, and the centerpiece of a 100-acre, private development, to include hotels, restaurants, cinemas, office space and housing. The convention center district is being developed at a total cost of $1.3 billion to improve Puerto

Rico's competitive position in the convention and group travel segments. The convention center opened on November 17, 2005.

The Convention Center District Authority also owns a multi-purpose coliseum located in San Juan, Puerto Rico. The coliseum, known as the Jose Miguel Agrelot Coliseum, was inaugurated in 2004 and has been host to various successful artistic and other events.

Government

The government sector of Puerto Rico plays an important role in the economy. In fiscal year 2007, the government accounted for $8.6 billion of Puerto Rico's gross domestic product, or 9.6% of the total. The government is also a significant employer, providing jobs for 281,300 workers, or 27.6% of total, non-farm, payroll employment in fiscal year 2008. This total includes municipal employees. From fiscal year 2005 to fiscal year 2008, Commonwealth and municipal government employment has been reduced by approximately 11,700 positions.

On February 25, 1998, legislation was enacted permitting the unionization of employees of the central government (excluding municipal employees). Under this law, government employees are given collective bargaining rights subject to a number of limitations. Among those limitations are: employees are prohibited from striking; salary increases are contingent on the availability of budgeted revenues; employees cannot be required to become union members and pay union dues; and collective bargaining negotiations cannot occur in an election year. During the current administration, of 100 collective bargaining agreements to be negotiated, 99 have been signed, of which 89 include the economic terms.

Transportation

Thirty-four shipping lines offer regular ocean freight service to eighty United States and foreign ports. San Juan is the island's leading seaport, but there are also seaport facilities at other locations in Puerto Rico including Arecibo, Culebra, Fajardo, Guayama, Guayanilla, Mayagüez, Ponce, Vieques, and Yabucoa.

Luis Muñoz Marín International Airport is currently served by 25 United States and international airlines. At present, there is daily direct service between San Juan and Atlanta, Boston, Chicago, Dallas, Miami, New York, Philadelphia, and numerous other destinations within the United States. There is also regularly scheduled service between Aguadilla and Ponce and New York and between Puerto Rico and other Caribbean islands and certain Latin American and European cities. A major United States airline uses San Juan as a hub for its intra-Caribbean airline service. Several smaller airports serve intra-island traffic.

The island's major cities are connected by a modern highway system, which, as of December 31, 2007, totaled approximately 4,625 miles of highways and 11,774 miles of local streets and adjacent roads. The highway system comprises 387 miles of primary system highways, which are the more important interregional traffic routes and include PR-52, PR-22, PR-53 and PR-20 toll highways, 230 miles of primary urban system highways, 959 miles of secondary system highways serving the needs of intra-regional traffic and 3,051 miles of tertiary highways and roads serving local, intra-regional traffic.

The first phase of a new mass transit system, known as Tren Urbano, has been completed. Tren Urbano serves a portion of metropolitan San Juan and is expected eventually to serve the municipalities of Carolina and Caguas as well. It currently has ridership of about 33,000 per day.

The Port of the Americas Authority ("PAA") is responsible for the development and operation of the Port of the Americas, a deep draft port on the south coast of Puerto Rico. The first phase of the Port of the Americas was completed in fiscal year 2004. This initial phase included the improvement of piers 4, 5 and 6 of the Port and the acquisition of heavy equipment at a cost of $40 million. During calendar year 2005, the PAA began the second phase of the Port, which phase is expected to be completed by the end of calendar year 2008. Completion of this second phase will provide capacity to handle up to 250,000 Twenty-Foot Equivalent Units ("TEU"). This second phase includes (i) dredging the entrance channel and adjacent areas of the Port to a depth of 50 feet; (ii) reconstructing the container terminals; (iii) commencing certain required environmental risk mitigation procedures; and (iv) preparing final construction schematics. With respect to these tasks, dredging is completed, the final design contract has been awarded, acquisition of environmental risk mitigation land is underway, and the contract for reconstruction of the container terminal was awarded in April 2006. The Port is expected to be capable of providing capacity for up to 700,000 TEUs when the third phase is completed.

As of July 30, 2008, PAA had an outstanding balance of $112.4 million under various lines of credit from GDB. PAA is authorized to borrow up to $250 million under these lines of credit. This debt is payable from annual legislative appropriations until the PAA starts generating revenues sufficient to cover debt service and is also guaranteed by the Commonwealth. Currently, the Port handles over 650,000 TEUs of breakbulk and a container terminal should be operational by the end of fiscal year 2008.

Construction

Although the construction industry represents a relatively small segment of the economy compared to other sectors, it has made significant contributions to the growth of economic activity, due to its multiplier effect on the whole economy. During the period from fiscal year 2003 through fiscal year 2007, however, real construction investment has decreased at an average annual growth rate of 5.9%. The total value of construction permits decreased by 5.4% during the same five fiscal year period.

Public investment has been an important component of construction investment. During fiscal year 2007, approximately 43.4% of the total investment in construction was related to public projects. For fiscal year 2007 compared to fiscal year 2006, the total value of construction permits decreased 22.2% and total sales of cement, including imports, decreased 8.2%. Average payroll employment in the construction sector during fiscal year 2007 was 66,700, a reduction of 1.0% from fiscal year 2006. Cement sales (including imports) fell by 10.7% during fiscal year 2008, the largest decline during the last decade.

Total construction investment for fiscal year 2007 decreased (in real terms) by 6.3% (following a 10.4% real decline in fiscal year 2006) due principally to the drop in construction related public projects. The Planning Board estimated construction investment decreases (in real terms) of 5.3% during fiscal year 2008 and stagnation (0% real growth) during fiscal year 2009. Public investment will be primarily in housing, new schools (and school reconstruction programs), water projects, and other public infrastructure projects. Public investment in construction has been negatively affected by the Commonwealth's fiscal difficulties.

During the first eleven months of fiscal year 2008, the number of construction permits decreased 13.8%, while the total value of construction permits increased 16.5% compared to the same period in fiscal year 2007.

Agriculture

The Department of Agriculture and related agencies have directed their efforts at increasing and improving local agricultural production, increasing efficiency and the quality of produce, and stimulating the consumption of locally produced agricultural products. During fiscal year 2007, gross income from agriculture was $814.2 million, an increase of 1.6% compared with fiscal year 2006. Agriculture gross income consists of the total value of production in the principal agricultural sectors, which include traditional crops, livestock and poultry, grains, vegetables, fruits, ornamental plants and other products. During fiscal year 2007, starchy vegetables, coffee, livestock products and ornamental plants contributed a higher percentage of the sector's income than in the previous fiscal year.

The Commonwealth supports agricultural activities through incentives, subsidies, and technical and support services, in addition to income tax exemptions for qualified income derived by bona fide farmers. Act No. 225 of 1995 provides a 90% income tax exemption for income derived from agricultural operations, an investment tax credit equal to 50% of the investment in qualified agricultural projects, and a 100% exemption from excise taxes, real and personal property taxes, municipal license taxes and tariff payments. It also provides full income tax exemption for interest income from bonds, notes and other debt instruments issued by financial institutions to provide financing to agricultural businesses. Subsequent legislation imposed an aggregate annual limit of $15 million on the investment tax credits available under Act No. 225.

Policy changes have been implemented to promote employment and income generated by the agricultural sector. The policy initiatives include a restructuring of the Department of Agriculture, an increase in government purchases of local agricultural products, new programs geared towards increasing the production and sales of agricultural products, and a new system of agricultural credits and subsidies for new projects.

Higher Education

During the five decades from 1950 to 2000, Puerto Rico made significant advances in the field of education, particularly at the college and graduate school level. The transformation of Puerto Rico during the 1950s and 1960s from an agricultural economy to an industrial economy brought about an increased demand for educational services at all levels. During the 1970s and 1980s, certain higher wage, higher technology industries became more prominent in Puerto Rico. More recently, employment in the services sector has increased significantly. This has resulted in an increased demand for workers having a higher level of education and greater expertise in various technical fields. During the same time period, enrollments in institutions of higher learning rose very rapidly due to growth in the college-age population, and the increasing proportion of college attendance by such population. During the 1990s and into the current decade, college attendance and college attendance as a percentage of the college-age population continued to increase, and the college-age population has declined since 2000.

The following table presents comparative trend data for Puerto Rico and the United States with respect to college-age population and the percentage of such population attending institutions of higher learning.

Commonwealth of Puerto Rico
Trend in College Enrollment

	Commonwealth of Puerto Rico			Mainland United States		
Academic Year	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent(1)**	**Population 18-24 Years of Age**	**Higher Education Enrollment**	**Percent(1)**
1970	341,448(2)	57,340	16.8%	23,714,000(2)	8,580,887	36.2%
1980	397,839(2)	130,105	32.7%	30,022,000(2)	12,096,895	40.3%
1990	417,636(2)	156,147	37.4%	26,961,000(2)	13,621,000	50.5%
2000	428,892(2)	176,015	41.0%	27,143,455(2)	15,313,000	56.4%
2001	426,194(3)	185,015	43.4%	27,971,000(3)	15,928,000	56.9%
2002	423,852(3)	190,776	45.0%	28,463,000(3)	16,612,000	58.4%
2003	420,295(3)	199,842	47.5%	28,947,000(3)	16,900,000	58.4%
2004	416,020(3)	207,074	49.8%	29,245,000(3)	17,272,000	59.1%
2005	411,580(3)	208,032	50.5%	29,307,000(3)	17,428,000	59.5%
2006	407,134(3)	209,547	51.5%	29,312,950(3)	17,672,000	60.3%
2007	396,057(3)	225,402	56.9%	29,492,415(3)	17,959,000	60.9%

(1) Number of persons of all ages enrolled in institutions of higher education as percent of population 18-24 years of age.
(2) Based on census population as of April 1 of the stated year.
(3) Estimated population (reference date July 1 of the stated year).

Sources: United States Census Bureau (Mainland United States Population), United States National Center for Education Statistics, Planning Board (Puerto Rico Population) and Council on Higher Education of Puerto Rico

The University of Puerto Rico, the only public university in Puerto Rico, has eleven campuses located throughout the island. The University's total enrollment for academic year 2006-2007 was approximately 62,340 students. The Commonwealth is legally bound to appropriate annually for the University of Puerto Rico an amount equal to 9.60% of the average annual revenue from internal sources for each of the two fiscal years immediately preceding the current fiscal year.

In addition to the University of Puerto Rico, there are 40 public and private institutions of higher education located in Puerto Rico. Such institutions had an enrollment during academic year 2005-2006 of approximately 145,574 students and provide programs of study in liberal arts, education, business, natural sciences, technology, secretarial and computer sciences, nursing, medicine, and law. Degrees are offered by these institutions at the associate, bachelor, master, and doctoral levels.

Enrollment at other postsecondary education programs, including technical and vocational programs, amounted to an additional 33,629 students at approximately 76 institutions. This figure represents enrollment at federal Title IV eligible, non-degree granting institutions reporting data to the National Center for Education Statistics (Integrated Postsecondary Education Data System).

Institutions providing education in Puerto Rico must satisfy state licensing requirements to operate. Also, the vast majority of educational institutions are accredited by USDE-recognized accrediting entities.

Tax Incentives

One factor that has promoted and continues to promote the development of the manufacturing sector in Puerto Rico is the various local and federal tax incentives available, particularly those under Puerto Rico's Industrial Incentives Program and, until recently, Sections 30A and 936 of the U.S. Code. Tax and other incentives have also been established to promote the development of the tourism industry. These incentives are summarized below.

Industrial Incentives Program

Since 1948, Puerto Rico has had various industrial incentives laws designed to stimulate industrial investment in the island. Under these laws, which are designed to promote investment in Puerto Rico, companies engaged in manufacturing and certain other designated activities were eligible to receive full or partial exemption from income, property, and other local taxes. The most recent of these industrial incentives laws is the Economic Incentives Act.

The benefits provided by the Economic Incentives Act, like those of the 1998 Tax Incentives Act, are available to new companies as well as companies currently conducting tax-exempt operations in Puerto Rico that choose to renegotiate their existing tax exemption grant, expand current operations or commence operating a new eligible business. The activities eligible for tax exemption under the Economic Incentives Act include manufacturing, certain designated services performed for markets outside Puerto Rico (including the United States), the production of energy from local renewable sources for consumption in Puerto Rico and laboratories for research and development. The Economic Incentives act expands the definition of manufacturing activity from that included in the 1998 Tax Incentives Act to include clusters and supply chains. Companies qualifying thereunder can benefit from a simplified income tax system: in most cases, an income tax rate of 4% and a withholding tax rate of 12%. Alternatively, the income tax rate can be 8% and the withholding rate 2%. Special rates apply to projects located in low and mid-development zones (an income tax reduction of 0.5%), local projects (an income tax rate of 3%), small businesses (an income tax rate of 1%) and pioneering activities (an income tax rate of 1%, but for research and development projects located completely in Puerto Rico the income tax rate may be 0%). In addition, as with the 1998 Tax Incentives Act, the Economic Incentives Act grants 90% exemption from property taxes, 100% exemption from municipal license taxes during the first three semesters of operations and between 60% and 80% thereafter, and 100% exemption from excise taxes with respect to the acquisition of raw materials and certain machinery and equipment used in the exempt activities.

The Economic Incentives Act is designed to stimulate employment and productivity, research and development, capital investment, reduction in the cost of energy and increased purchase of local products.

Under the Economic Incentives Act, as with the 1998 Tax Incentives Act, companies can repatriate or distribute their profits free of Puerto Rico dividend taxes. In addition, passive income derived from the investment of eligible funds in Puerto Rico financial institutions, obligations of the Commonwealth, and other designated investments are fully exempt from income and municipal license taxes. Individual shareholders of an exempted business are allowed a credit against their Puerto Rico income taxes up to 30% of their proportionate share of the exempted business's income tax liability. Gain from the sale or exchange of shares of an exempted business by its shareholders during the exemption period is subject to the same treatment as the eligible business income.

The Economic Incentives Act, like the 1998 Tax Incentives, Act also provides investors who acquire an exempted business that is in the process of closing its operations in Puerto Rico a 50% credit in connection with the cash purchase of such corporation's stocks or assets.

Tourism Incentives Program

For many years, Puerto Rico has also had incentives laws designed to stimulate investment in hotel operations on the island. The most recent of these laws, the Tourism Incentives Act of 1993 (the "Tourism Incentives Act"), provides partial exemptions from income, property, and municipal license taxes for a period of up to ten years. The Tourism Incentives Act also provides certain tax credits for qualifying investments in tourism activities, including hotel and condo-hotel development projects. Recently enacted legislation provides further tourism incentives by granting certain tax exemptions on interest income received from permanent or interim financing of tourism development projects and fees derived from credit enhancements provided to the financing of such projects. See "Government Development Bank for Puerto Rico – Tourism Development Fund" under *Public Corporations*.

As part of the incentives to promote the tourism industry, the Commonwealth established the Tourism Development Fund as a subsidiary of GDB with the authority to (i) make investments in or provide financing to entities that contribute to the development of the tourism industry and (ii) provide financial guarantees and direct loans for financing hotel development projects. To date, the Fund has provided direct loans and financial guarantees for loans made or bonds issued to finance the development of seventeen hotel projects representing over 3,900 new hotel rooms.

Incentives under the U.S. Code

United States corporations operating in Puerto Rico have been subject to special tax provisions since the Revenue Act of 1921. Prior to enactment of the Tax Reform Act of 1976, under Section 931 of the U.S. Code, United States corporations operating in Puerto Rico (and meeting certain source of income tests) were taxed only on income arising from sources within the United States.

The Tax Reform Act of 1976 created Section 936 of the U.S. Code, which revised the tax treatment of United States corporations operating in Puerto Rico by taxing such corporations on their worldwide income in a manner similar to that applicable to any other United States corporation but providing such corporations a full credit for the federal tax on their business and qualified investment income in Puerto Rico. The credit provided an effective 100% federal tax exemption for operating and qualifying investment income from Puerto Rico sources.

As a result of amendments to Section 936 of the U.S. Code made in 1996 (the "1996 Amendments"), its income tax credit based on operating and certain investment income was phased out over a ten-year period for companies that were operating in Puerto Rico in 1995, and is no longer available.

Controlled Foreign Corporations

Because of the modification and phase out of the federal tax incentives under Section 936 of the U.S. Code, many corporations previously operating thereunder reorganized their operations in Puerto Rico to become controlled foreign corporations ("CFCs"). A CFC is a corporation that is organized outside the United States and is controlled by United States shareholders. In general, a CFC may defer the payment of federal income taxes on its trade or business income until such income is repatriated to the United States in the form of dividends or through investments in certain United States properties. The Puerto Rico Office of Industrial Tax Exemption has received notification from numerous corporations that have converted part or all of their operations to CFCs. These include most of the major pharmaceutical, instrument and electronics manufacturing companies in Puerto Rico.

CFCs operate under transfer pricing rules for intangible income that are different from those applicable to United States corporations operating under Section 936 of the U.S. Code ("Section 936 Corporations"). In many cases, they are allowed to attribute a larger share of this income to their Puerto Rico operation but must make a royalty payment "commensurate with income" to their U.S. affiliates. Section 936 Corporations were exempted from Puerto Rico withholding taxes on any cost sharing payments they might have opted to make, but CFCs are subject to a fifteen percent Puerto Rico withholding tax on royalty payments.

Recently, the United States Congress approved legislation that would extend the benefit of Section 199 of the U.S. Code to production activities that take place in Puerto Rico. Section 199 provides a three-point reduction in the federal income tax rate, phased in over five years (from 35% to 31.85% after 2009). This extension applies to the U.S. branch activities located on the island and are not controlled foreign corporations.

DEBT

Public Sector Debt

Public sector debt comprises bonds and notes of the Commonwealth, its municipalities, and public corporations ("notes" as used in this section refers to certain types of non-bonded debt regardless of maturity), subject to the exclusions described below.

Section 2 of Article VI of the Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes theretofore issued which is payable in any fiscal year, together with any amount paid by the Commonwealth in the fiscal year preceding the fiscal year of such proposed issuance on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenues raised under the provisions of Commonwealth legislation and deposited into the Treasury (hereinafter "internal revenues") in the two fiscal years preceding the fiscal year of such proposed issuance. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded through payments by the Commonwealth on such guaranteed debt. Internal revenues consist principally of income taxes, property taxes and excise taxes. Certain revenues, such as federal excise taxes on offshore shipments of alcoholic beverages and tobacco products and customs duties, which are collected by the United States Government and returned to the Treasury and motor vehicle fuel taxes and license fees, which are allocated to the Highway and Transportation Authority, are not included as internal revenues for the purpose of calculating the debt limit, although they may be available for the payment of debt service. In addition, the portion of the Sales Tax (as defined under "Tax Reform" under *Puerto Rico Taxes, Other Revenues, and Expenditures* below) allocated to the Puerto Rico Sales Tax Financing Corporation is also not included as internal revenues consistent with the legislation creating the Sales Tax Financing Corporation, which legislation provides that such portion is not "available resources" under the Constitutional provisions relating to the Bonds.

All or a portion of the proceeds of certain refunding bonds issued by the Commonwealth were invested in guaranteed investment contracts or federal agency securities (in each case rated in the highest category by Moody's Investors Service ("Moody's") and Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), none of which is eligible to be used for a legal defeasance under Puerto Rico law ("non-eligible investments")). Since bonds refunded with proceeds of non-eligible investments are not legally defeased, such bonds are treated as outstanding for purposes of the 15% debt limitation.

Future maximum annual debt service for the Commonwealth's outstanding general obligation debt is $930,600,143 in the fiscal year ending June 30, 2016 (based on the assumption that the Public Improvement Refunding Bonds, Series 2004 A, which are variable rate bonds, bear interest at their actual rate per annum through July 1, 2012 and thereafter at 12% per annum, and the Public Improvement Refunding Bonds, Series 2004 B, the Public Improvement Refunding Bonds, Series 2008 B, a portion of the Public Improvement Refunding Bonds, Series 2003 C, a portion of the Public Improvement Bonds of 2006, Series A, and a portion of the Public Improvement Refunding Bonds, Series 2007A, each of which are also variable rate bonds, bear interest at 12% per annum). This amount ($930,600,143) is equal to 11.38% of $8,178,090,500, which is the average of the adjusted internal revenues for the fiscal years ended June 30, 2007 and June 30, 2008. If bonds refunded with non-eligible investments described in the preceding paragraph were treated as not being outstanding, and the interest on the Public Improvement Refunding Bonds, Series 2004 B, the Public Improvement Refunding Bonds, Series 2008 B, the portion of the Public Improvement Refunding Bonds, Series 2003 C, the portion of the Public Improvement Bonds of 2006, Series A, and the portion of the Public Improvement Refunding Bonds, Series 2007A, was calculated using the effective fixed interest rate payable by the Commonwealth under the interest rate exchange agreements entered into in respect thereof, the percentage referred to in the preceding sentence would be 9.39% and future maximum annual debt service for the Commonwealth's outstanding general obligation debt would be $767,794,551 in the fiscal year ending June 30, 2020. Annual debt service payments on the PRASA guaranteed bonds are not included in the calculation of the 15% debt limitation. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund, and such debt service would be included in the calculation of the 15% debt limitation.

The Commonwealth's policy has been and continues to be to maintain the amount of such debt prudently below the constitutional limitation. Debt of municipalities, other than bond anticipation notes, is supported by real and personal property taxes and municipal license taxes. Debt of public corporations, other than bond anticipation notes, is generally supported by the revenues of such corporations from rates charged for services or products. See *Public Corporations.* However, certain debt of public corporations is supported, in whole or in part, directly or indirectly, by Commonwealth appropriations or taxes.

Direct debt of the Commonwealth is issued pursuant to specific legislation approved in each particular case. Debt of the municipalities is issued pursuant to ordinances adopted by the respective municipal assemblies. Debt of public corporations is issued in accordance with their enabling statutes. GDB, as fiscal agent of the Commonwealth and its municipalities and public corporations, must approve the specific terms of each issuance.

The following table presents a summary of public sector debt as of June 30, 2008. Excluded from the table is debt not primarily payable from either Commonwealth or municipal taxes, Commonwealth appropriations or rates charged by public corporations for services or products, some of which debt is set forth in footnote 4 below. Also excluded from the table is debt the inclusion of which would reflect double counting including, but not limited to, $1.4 billion of outstanding bonds (as of June 30, 2008) issued by the Municipal Finance Agency to finance its purchase of bonds of Puerto Rico municipalities, and $2.4 billion of obligations of the Public Finance Corporation issued to purchase certain Commonwealth public sector debt.

Commonwealth of Puerto Rico
Public Sector Debt
(in millions)

	June 30, 2008
Direct full faith and credit obligations[1]	$ 8,759
TRANs line of credit	--
Sales Tax debt[2]	7,690
Municipal debt	2,819
Puerto Rico guaranteed debt[3]	4,104
Debt supported by Puerto Rico appropriations or taxes[4]	1,322
Public corporations and agencies	21,989
Sub-total	46,682
Limited obligation/non-recourse debt[5]	6,265
Total public sector debt	$ 52,947

(1) Includes general obligation bonds and tax and revenue anticipation notes ("TRANs").
(2) Includes Public Finance Corporation and Sales Tax Financing Corporation Bonds.
(3) Consists of $599.3 million of bonds issued by Aqueduct and Sewer Authority, $293.3 million of State Revolving Fund Loans incurred under various federal water laws, $112.4 million of bonds issued by Port of the Americas Authority and $3.099 billion of Public Buildings Authority bonds. Excludes $267 million of GDB bonds payable from available moneys of GDB.
(4) Represents bonds and notes payable from the Commonwealth General Fund and Public Improvement Fund.
(5) Includes the following: $1.2 billion of Children's Trust bonds which are payable solely from the payments to be received pursuant to the tobacco litigation settlement; $596.3 million of Housing Finance Authority bonds, which are payable from Puerto Rico Housing Administration's annual allocation of Public Housing Capital Funds from the United States Department of Housing and Urban Development; $153 million of Special Facilities Revenue Bonds issued by the Highways and Transportation Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge; $155 million of Special Facilities Bonds issued by the Ports Authority, which are solely payable from the pledge of certain payments made by a private corporation under a special facilities agreement; $81.2 million of Educational Facilities Revenue Bonds, 200 Series A (University Plaza Project) issued by the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority, which are payable from rent payments made by the University of Puerto Rico; approximately $84.7 million of bonds issued by the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority to finance the construction of various government infrastructure projects, which are payable from rent payments made by various government entities; and $2.948 billion of Employees Retirement System Senior Pension Funding Bonds, Series A, B and C.

Source: Government Development Bank for Puerto Rico

No deductions have been made in the table above for debt service funds and debt service reserve funds. The table above and the amounts shown throughout this section as representing outstanding debt include outstanding capital appreciation bonds at their respective original principal amounts and do not include any accretion thereon.

Debt Service Requirements for Commonwealth General Obligation Bonds

The following table presents the debt service requirements for Commonwealth general obligation bonds outstanding as of June 30, 2008.

The table excludes debt service on $1.08 billion of general obligation bonds refunded with refunding bonds the proceeds of which, pending the redemption of the refunded bonds, were invested in guaranteed investment contracts or other securities not eligible to effect a legal defeasance. Such refunded bonds will be considered to be outstanding under their respective authorizing resolutions and for purposes of calculating the Commonwealth's constitutional debt limitation described above. In addition, in respect of certain variable rate, general obligation bonds as to which the Commonwealth has entered into interest rate exchange agreements, the interest in the table is calculated by using the respective fixed rates of interest that the Commonwealth is paying under said agreements. Debt service requirements for each fiscal year, as shown in the following table, include principal and interest due on July 1 immediately following the close of such fiscal year.

Puerto Rico Debt Service Requirements*
(in thousands)

Fiscal Year Ending June 30	Outstanding Bonds Principal	Interest	Total Debt Service[1]
2009	$ 78,650	$ 324,582	$ 403,232
2010	314,005	431,675	745,679
2011	328,432	414,697	743,130
2012	358,090	391,784	749,874
2013	382,550	370,441	752,991
2014	369,913	370,613	740,525
2015	401,805	352,794	754,599
2016	421,560	332,895	754,455
2017	367,872	312,280	680,151
2018	370,285	293,917	664,202
2019	473,211	259,659	732,870
2020	539,950	227,845	767,795
2021	414,765	200,715	615,480
2022	344,310	181,722	526,032
2023	313,785	166,659	480,444
2024	305,035	153,333	458,368
2025	318,815	141,217	460,032
2026	324,180	126,244	450,424
2027	338,910	109,829	448,739
2028	357,125	92,023	449,148
2029	329,025	76,241	405,266
2030	341,510	59,734	401,244
2031	359,900	44,223	404,123
2032	196,290	27,702	223,992
2033	167,910	18,122	186,032
2034	120,785	11,222	132,007
2035	55,380	6,117	61,497
2036	30,400	3,276	33,676
2037	32,000	1,680	33,680
	$8,756,447	$5,503,240	$14,259,686

* Totals may not add due to rounding. Excludes the debt service on certain economically (but not legally) defeased general obligation bonds and includes the effective fixed rate on certain variable rate general obligation bonds as to which the Commonwealth has entered into interest rate exchange agreements.

(1) In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund. See "Other Public Corporations - Aqueduct and Sewer Authority" under *Public Corporations* below.

Sources: Government Development Bank for Puerto Rico and Department of the Treasury

Ratings of Commonwealth General Obligation Bonds

On July 2, 2008, Moody's confirmed its "Baa3" rating on the Commonwealth's general obligation debt, and its stable ratings outlook thereon. On November 26, 2007, Moody's confirmed its "Ba1" rating on the Commonwealth's appropriation debt, and its stable ratings outlook thereon.

On April 24, 2008, S&P confirmed its "BBB-" rating of the Commonwealth's general obligation and appropriation debt, and its stable outlook thereon.

Commonwealth Guaranteed Debt

As of December 31, 2007, $3.09 billion of Commonwealth guaranteed bonds of the Public Buildings Authority were outstanding. Maximum annual debt service on these bonds is $236.2 million in fiscal year ending June 30, 2011, with their final maturity being July 1, 2037. No payments under the Commonwealth guaranty have been required to date for these bonds.

As of June 30, 2008, $267 million of Commonwealth guaranteed bonds of GDB were outstanding. No payments under the Commonwealth guaranty have been required for these bonds.

As of June 30, 2008, GDB held approximately $112.4 million of the Port of the Americas Authority's outstanding bonds, which are guaranteed by the Commonwealth. The Authority is authorized to issue and GDB is authorized to purchase its bonds guaranteed by the Commonwealth in a maximum aggregate principal amount of $250 million. The proceeds from these bonds will be used to continue the development of the Port of the Americas. No payments under the Commonwealth guaranty have been required for these bonds.

As of June 30, 2008, the aggregate outstanding principal amount of obligations of PRASA guaranteed by the Commonwealth was $892.6 million. This amount consisted of $284.7 million in revenue bonds sold to the public, $314.6 million in bonds issued to the United States Department of Agriculture, Rural Development, and $293.3 million of loans by the State Revolving (Clean Water and Safe Drinking Water Act) Funds for the benefit of PRASA. From January 1997 through fiscal year 2005, the Commonwealth made debt service payments under its guaranty. Beginning with the debt service payment due January 1, 2006, the Commonwealth stopped making guarantee payments on these obligations. PRASA has resumed making payment on this debt. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed obligations, the Commonwealth would be required once more to make such payments from the General Fund under its guarantee. See "Other Public Corporations – Aqueduct and Sewer Authority" under *Public Corporations* below.

Trends of Public Sector Debt

The following table shows the growth rate of short-term and long-term public sector debt and the growth rate of Gross National Product (in current dollars) for the five fiscal years ended June 30, 2008. As of June 30, 2008, outstanding short-term debt, relative to total debt, was 7.0%.

Commonwealth of Puerto Rico
Public Sector Debt and Gross National Product
(dollars in millions)*

June 30,	Public Sector: Long Term(2)	Short Term(3)	Short Term as % of Total	Total	Rate of Increase	Gross National Product(1): Amount	Rate of Increase
2004	$31,767	$2,175(4)	6.4%	$33,942	14.3%	$50,709	6.8%
2005	34,789	1,914(4)	5.2	36,703	8.1	53,752	6.0
2006	37,313	2,620(4)(5)	6.6	39,933	8.8	56,733	5.5
2007	39,492	3,326	7.8	42,818	7.2	58,712	3.5
2008	43,413	3,269	7.0	46,682	9.0	N/A	N/A

* Totals may not add due to rounding.
(1) In current dollars.
(2) Does not include the bonds identified in footnote 5 of the table above entitled "Commonwealth of Puerto Rico – Public Sector Debt", which would have been issued and outstanding at the time, all of which would be considered long-term debt.
(3) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(4) Does not include the tax and revenue anticipation notes that were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(5) Includes a $368 million line of credit from GDB to the Secretary of the Treasury, the proceeds of which were applied to pay debt service on general obligation bonds.

Source: Government Development Bank for Puerto Rico

The following table shows the trend of public sector debt by major category for the five fiscal years ended June 30, 2008.

Commonwealth of Puerto Rico
Public Sector Debt by Major Category
(dollars in millions)*

June 30,	Commonwealth: Long Term	Short Term(2)	Total	Municipalities: Long Term	Short Term(2)	Total	Public Corporation(1): Long Term	Short Term(2)	Total	Total: Long Term	Short Term(2)	Total
2004	$7,758	$761(3)	$8,519	$1,820	$226	$2,046	$22,190	$1,187	$23,377	$31,767	$2,175	$33,942
2005	8,761	257(3)	9,018	1,927	254	2,181	24,101	1,403	25,504	34,789	1,914	36,703
2006	9,841	552(3)(4)	10,393	2,037	293	2,330	25,435	1,775	27,210	37,313	2,620	39,933
2007	10,335	224	10,559	2,164	299	2,463	26,993	2,803	29,796	39,492	3,326	42,818
2008	9,273	519	9,792	2,507	313	2,820	31,633	2,437	34,070	43,413	3,269	46,682

* Totals may not add due to rounding.
(1) Includes Commonwealth guaranteed debt; does not include the bonds identified in footnote 5 of the table above entitled "Commonwealth of Puerto Rico – Public Sector Debt".
(2) Obligations (other than bonds) issued with an original maturity of three years or less and lines of credit with a remaining maturity of three years or less are considered short-term debt.
(3) Does not include the tax and revenue anticipation notes which were outstanding at the close of the indicated fiscal years because prior to the end of said fiscal years sufficient funds had been set aside for the payment of such notes in full.
(4) Includes a $368 million line of credit from GDB to the Secretary of the Treasury, the proceeds of which were applied to pay debt service on general obligation bonds.

Source: Government Development Bank for Puerto Rico

PUBLIC CORPORATIONS

In Puerto Rico, many governmental and quasi-governmental functions are performed by public corporations created by the Legislative Assembly with varying degrees of independence from the central government to perform generally a single function or a limited number of related functions. Most public corporations obtain revenues from rates charged for services or products, but many are subsidized to some extent by the central government. Most public corporations are governed by boards whose members are appointed by the Governor with the advice and consent of the Senate, but some public corporations are attached to departments of the central government. Capital improvements of most of the larger public corporations are financed by revenue bonds issued under trust agreements or bond resolutions, or notes issued under loan agreements. The following table presents the outstanding bonds and notes of certain of the public corporations as of June 30, 2008 ("notes" as used in this section refers primarily to certain types of non-bonded debt regardless of maturity). Debt of certain other public corporations is excluded from this table because such debt is payable primarily from funds or grants provided by the federal government, is payable from sources other than Commonwealth appropriations or taxes or revenues of public corporations, or is payable from revenues derived from private sector services or products, such as industrial development bonds. Also excluded from this table is debt of certain public corporations the inclusion of which would reflect double counting. No deductions have been made in the table for debt service funds and debt service reserve funds. More detailed information about the major public corporations is presented in the following sections.

Commonwealth of Puerto Rico
Outstanding Debt of Public Corporations
June 30, 2008
(in thousands)

								Total Bonds and Notes	
		Bonds			Notes				
	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total	With Guaranty	Without Guaranty	Total
Aqueduct and Sewer Authority	$ 599,348	$ 1,338,649	$ 1,937,997	$293,291	$109,472	$402,763	$ 892,639	$ 1,448,121	$ 2,340,760
Convention Center District Authority	-	465,800	465,800	-	150,739	150,739	-	616,539	616,539
Electric Power Authority	-	6,195,202	6,195,202	-	1,121,849	1,121,849	-	7,317,051	7,317,051
Highway and Transportation Authority	-	6,428,074[1]	6,428,074	-	483,571	483,571	-	6,911,645	6,911,645
Housing Finance Authority[2]	-	484,365	484,365	-	52,725	52,725	-	537,090	537,090
Industrial Development Company	-	263,744	263,744	-	89,075	89,075	-	352,819	352,819
Infrastructure Financing Authority	-	1,876,578[3]	1,876,578	-	24,512	24,512	-	1,901,090	1,901,090
Port of the Americas Authority	112,414	-	112,414	-	-	-	112,414	-	112,414
Ports Authority	-	61,315[5]	61,315	-	624,260	624,260	-	685,575	685,575
Public Buildings Authority	3,098,773	-	3,098,773	-	75,000	75,000	3,098,773	75,000	3,173,773
Public Finance Corporation	-	1,695,311[4]	1,695,311	-	103,936	103,936		1,799,247	1,799,247
P.R. Sales Taxes Financing Corp. (COFINA)	-	5,237,749	5,237,749	-	-	-	-	5,237,749	5,237,749
University of Puerto Rico	-	584,998[6]	584,998	-	34,128	34,128	-	619,126	619,126
Others	-	-	-	-	2,465,791	2,465,791	-	2,465,791	2,465,791
Total[7]	$3,810,535	$24,631,785	$28,442,320	$293,291	$5,335,058	$5,628,349	$4,103,826	$29,966,843	$34,070,669

(1) Excludes $153 million of Special Facilities Revenue Bonds issued by the Highway and Transportation Authority, which are payable from net toll revenues collected from the Teodoro Moscoso Bridge.
(2) Excludes the $596.3 million of Housing Finance Authority bonds, which are payable solely from Puerto Rico Public Housing Administration's annual allocation of Public Housing Capital Funds from the United States Department of Housing and Urban Development.
(3) Excludes $1 billion of outstanding bonds of Infrastructure Financing Authority, which bonds are payable solely from the investment income of funds on deposit in the Infrastructure Development Fund consisting of proceeds from the sale of a controlling interest in Puerto Rico Telephone Company.
(4) Payable primarily from Commonwealth appropriations.
(5) Excludes $155 million of Special Facilities Bonds issued by the Ports Authority, which bonds are payable solely from by the pledge of certain payments made by a private corporation under a special facilities agreement.
(6) Excludes $81.2 million of Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) issued by the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority, which bonds are payable from rent payments made by the University of Puerto Rico.
(7) Excludes accretion of interest from the respective issuance dates on capital appreciation bonds. Also excludes $1.2 billion original principal amount of Children's Trust Tobacco Settlement Asset-Backed Bonds, Series 2002, which bonds will be repaid from payments made by certain tobacco companies under a master settlement agreement. See "Other Public Corporations" below.

Source: Government Development Bank for Puerto Rico

Government Development Bank for Puerto Rico

The principal functions of GDB are to act as financial advisor to and fiscal agent for the Commonwealth, its municipalities and public corporations in connection with the issuance of bonds and notes, to make loans and advances to public corporations and municipalities, and to make loans to private enterprises to aid in the economic development of Puerto Rico.

As of May 31, 2008, just under $2 billion of bonds and notes of GDB (excluding its subsidiaries) were outstanding, consisting of $267 million in Commonwealth guaranteed bonds and $1.5 billion of medium term senior notes. Act No. 12 of May 9, 1975, as amended, provides that the payment of principal of and interest on specified notes and other obligations of GDB, not exceeding $550 million, may be guaranteed by the Commonwealth, of which $267 million were outstanding as of May 31, 2008. As of said date, GDB also had $4.7 billion in loans outstanding to the central government of the Commonwealth and its public corporations and municipalities.

Act No. 82 of June 16, 2002 ("Act No. 82") amended GDB's Charter to authorize GDB to transfer annually to the General Fund, beginning with fiscal year 2001, up to 10% of its audited net income or $10,000,000, whichever is greater. GDB is not required by Act No. 82 to transfer any funds. GDB made payments to the General Fund of $11.6 million for fiscal year 2003 and $18.4 million for fiscal year 2004. GDB did not make a payment to the General Fund under Act No. 82 for fiscal years 2005, 2006, 2007 and 2008 and does not expect to make a payment for fiscal year 2009.

Under Act No. 271 of November 21, 2002, GDB made a required special capital contribution to the Special Communities Perpetual Trust (the "Trust") of $500 million and provided the Trust with a $500 million, non-revolving, line of credit. The amounts transferred to the Trust were deposited in two investment accounts held by GDB for the benefit of the Trust. As of May 31, 2008, the Trust had repaid $123.9 million of its line of credit and had an outstanding balance of $376 million. The line of credit is payable from legislative appropriations.

GDB has several subsidiaries which perform various functions. The principal subsidiaries and their functions are listed below:

Housing Finance Authority. Housing Finance Authority (formerly known as Housing Finance Corporation) was created to provide needed rental housing units and stimulate the construction industry under federally subsidized programs. Effective February 8, 2002, Housing Finance Corporation became the Housing Finance Authority and the Housing Bank and Finance Agency was dissolved and its powers transferred to the Housing Finance Authority. Housing Finance Authority provides financing for rental housing units, stimulates the construction industry under federally subsidized programs and provides interim financing for low-income housing projects and single-family homeownership programs. It is also engaged in insuring and servicing mortgages originated by the former Housing Bank and Finance Agency. As of June 30, 2008, Housing Finance Authority's total outstanding loans to the private sector for development of housing projects targeted to low and moderate income families were $111.7 million. The Authority's mortgage loans to low and moderate income homeowners represented an additional $98.5 million as of the same date.

Housing Finance Authority has outstanding tax-exempt revenue bonds and notes that were issued to finance the construction of housing units approved for federal rental subsidies and to finance home ownership of single family housing units. Such bonds and notes are generally limited obligations of Housing Finance Authority payable solely from revenues collected from such housing units, with certain exceptions. As of June 30, 2008, $1.279 billion of Housing Finance Authority bonds were outstanding.

As of June 30, 2008, the Authority also had outstanding $677.1 million of bonds and notes issued to fund certain payments of the Commonwealth under its mortgage subsidy and other programs for low and moderate income families, and to guarantee certain insurance obligations of the former Housing Bank and Finance Agency.

As of June 30, 2008, the Authority had total notes and bonds outstanding of $1.394 billion (including $52.7 million of debt outstanding under GDB lines of credit, $10.2 million in notes payable and $52.4 million owed under repurchase agreements) and total unrestricted net assets of $460.9 million.

Tourism Development Fund. The Tourism Development Fund promotes Puerto Rico's hotel and tourism industry by making available direct loans and guarantees to secure the private financing for new hotel development projects. The Tourism Development Fund is also authorized to make capital investments in tourism related projects. As of June 30, 2008, the Tourism Development Fund had outstanding direct loans in an aggregate principal amount of $271.9 million and guarantees issued in the outstanding amount of $127.1 million to finance several hotels and tourism-related projects.

The Tourism Development Fund has made payments under its guarantees and letters of credit in the aggregate amount of approximately $313.4 million with respect to several projects, including $282 million disbursed to pay in full the bonds issued to finance three projects, which bonds had been declared due and payable at the direction of the Tourism Development Fund due to the failure of the applicable borrowers to comply with their obligations under the related reimbursement agreements. Of the total amount disbursed, the Tourism Development Fund has been able to recover approximately $199.7 million from the borrowers. After taking these payments and all related recoveries into account, the unrestricted net assets of the Tourism Development Fund as of June 30, 2008, were approximately $150.5 million, and its allowances for losses on guarantees, loans, other assets and letters of credit were approximately $25.9 million.

Capital Fund. The Government Development Bank for Puerto Rico Capital Fund (the "Capital Fund") invests and trades in debt obligations and publicly traded shares of domestic and foreign corporations separate from GDB's general investment operations. As of May 31, 2008, the Capital Fund had assets of $87.3 million, of which $44.1 million were invested in an equity index fund that invests mainly in growth, value, small cap and international stocks.

Development Fund. The Puerto Rico Development Fund (the "Development Fund") provides an alternate source of financing to private enterprises in Puerto Rico that have difficulties in obtaining financing from traditional sources. The Development Fund also guarantees obligations of these enterprises and invests in their equity securities. As of May 31, 2008, the Development Fund had an investment of $3.3 million in preferred shares of a private entity. In addition, the Development Fund provided guarantees of $9.8 million, to guarantee 33% of loans under the "Key to Your Business" program of the Economic Development Bank. As of May 31, 2008, the allowance for guarantees was approximately $825,000.

Public Finance Corporation. Puerto Rico Public Finance Corporation ("Public Finance Corporation") provides agencies and instrumentalities of the Commonwealth with alternate means of meeting their financing requirements. Public Finance Corporation currently holds notes payable by the Commonwealth, the Maritime Shipping Authority, the Office for the Improvement of Public Schools, the Department of Health, and the Aqueduct and Sewer Authority, among others. As of May 31, 2008, it had $2.4 billion aggregate principal amount of bonds outstanding. All such bonds are limited, non-recourse obligations of Public Finance Corporation payable from the Puerto Rico Sales Tax Financing Corporation and/or Commonwealth appropriations made to pay the notes held by Public Finance Corporation. In addition, Public Finance Corporation had $104 million of notes outstanding under a line of credit with GDB whose proceeds were used to pay fiscal year 2007 debt service on its bonds due to the failure of the Commonwealth to make the required debt service appropriations on account of its fiscal problems.

Sales Tax Financing Corporation ("COFINA") was created by Act No. 91 of the Legislative Assembly of Puerto Rico, approved May 13, 2006, as amended ("Act 91"), for the purpose of financing the payment, retirement or defeasance of certain appropriation-backed debt outstanding as of June 30, 2006. Act 91 vested COFINA with all the powers conferred on Government Development Bank under its charter (other than the power to act as fiscal agent), including the power to issue bonds for its corporate purposes, to the extent required in order for the Corporation to carry out the purposes for which it was created. Act 91 provides that present and future collections of the pledged sales tax be transferred to COFINA in exchange for, and in consideration of, COFINA's commitment to pay, or establish mechanisms to pay, all or part of virtually all appropriation-backed debt outstanding as of June 30, 2006 with the net proceeds of the bonds issued by COFINA and with other funds and resources available to COFINA. As of June 30, 2008, $5.2 billion of COFINA's bonds were outstanding, the net proceeds of all of which bonds were used to refinance and retire outstanding debt of Public Finance Corporation.

A description of certain other affiliates of GDB is provided in "Other Public Corporations" below.

Other Public Corporations

Aqueduct and Sewer Authority. Puerto Rico Aqueduct and Sewer Authority ("PRASA") owns and operates the island's public water supply and sanitary sewer facilities systems (the "Systems").

PRASA needs to make substantial investments in infrastructure and a major overhaul of its operations to maintain the viability of the Systems and to finance its expansion for new users. Funds for this investment will be provided through a combination of revenues from PRASA, financing transactions, federal grants and other sources. Debt service on revenue bonds is payable from net revenues of the Systems after payment of current expenses. Due to PRASA's financial difficulties and its inability to access the bond market, the Commonwealth guarantees the principal and interest payments to the bondholders of all outstanding revenue bonds issued by PRASA, including those issued to the United States Department of Agriculture, Rural Development, and loans granted by the Clean Water and Drinking Water State Revolving Funds for the benefit of PRASA. In February 2004, this guaranty was extended through new legislation to include debt obligations issued until 2010.

PRASA reported net operational losses of $361 million and net operational income of $31.2 million during fiscal years 2006 and 2007, respectively. The total debt of PRASA was $2.341 billion as of June 30, 2008.

As part of its efforts to regain fiscal independence, PRASA implemented substantial increases in water and wastewater service rates in two phases. The first phase took effect on October 10, 2005. The second phase took effect on July 1, 2006. In the event PRASA is unable to make any portion of the future debt service payments on its guaranteed bonds, the Commonwealth would be required to make such payments under its guarantee from the General Fund. PRASA has also begun to pay from its revenues the debt service on a note it issued to Public Finance Corporation (in the principal amount of $368.3 million), which note financed the cost of the north coast super-aqueduct, as well as notes issued to Public Finance Corporation (in the principal amount of approximately $747 million), which notes financed its operations.

In June 2006, PRASA entered into an agreement to plead guilty to an indictment charging 15 felony counts of violating the federal Clean Water Act through the illegal discharge of pollutants from nine sanitary wastewater treatment plants and five drinking water treatment plants. Under the plea agreement, PRASA will pay a criminal fine of $9 million and was placed on five years' probation. PRASA and the United States also reached a comprehensive civil settlement to resolve repeated environmental violations at 62 wastewater treatment plants throughout the Commonwealth. According to the civil settlement, PRASA will spend an estimated $1.7 billion implementing approximately 145 capital improvement projects and other remedial measures at all of its wastewater treatment plants and related collection systems over the next 15 years. In December 2006, PRASA and the Commonwealth Department of Health executed a settlement agreement superseding 180 administrative orders against, and three prior settlement agreements with, PRASA. Under the terms of this agreement, PRASA paid a civil penalty of $1.0 million and agreed to implement short, medium and long-term work plans, as well as interim mitigation and preventative measures, all to bring PRASA's water system into compliance with federal and Commonwealth potable water regulations. The total cost of complying with this settlement agreement is expected to be between $700 and $800 million.

Children's Trust is a not-for-profit corporate entity created in 1999 as a public instrumentality of the Commonwealth. The Commonwealth has transferred to Children's Trust all of its rights, title and interest under the tobacco litigation Master Settlement Agreement, including the Commonwealth's right to receive initial, annual and strategic contribution payments to be made by the participating cigarette manufacturers under the Master Settlement Agreement.

Children's Trust issued $1.2 billion Tobacco Settlement Asset-Backed Bonds in October 2002. The bond proceeds were used, among other things, to pay the cost of certain capital expenses of the Commonwealth and certain capital and working capital expenses of PRASA. On June 30, 2005, the Children's Trust issued $108.2 million subordinate Tobacco Settlement Asset-Backed Bonds to pay working capital expenses of the Commonwealth. On May 1, 2008, Children's Trust issued $195.9 million of subordinate Tobacco Settlement Asset-Backed Bonds. As of June 30, 2008, the outstanding principal amount of the Trust's bonds was $1.4 billion. These bonds and any other additional senior bonds issued by Children's Trust are secured by a statutory pledge of the payments made and to be made by the participating cigarette manufacturers under the Master Settlement Agreement. To date, all principal and interest payments required to be made by the Trust on its outstanding bonds have been made on a timely basis from contribution payments made by the participating cigarette manufacturers under the Master Settlement Agreement.

Convention Center District Authority. The Convention Center District Authority was created to own, develop, finance, plan, design, build, operate, maintain, administrate and promote a new convention center and designated private parcels located within the Convention Center District in San Juan. The convention center opened on November 17, 2005.

The Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority ("AFICA") financed the construction of a multi-purpose coliseum in San Juan, known as the José Miguel Agrelot Coliseum, with a line of credit provided by GDB. The Coliseum was transferred to the Convention Center District Authority along with the associated line of credit. As of June 30, 2008, this line of credit with GDB had an outstanding balance of $150.7 million, which is expected to be paid from the proceeds of Commonwealth general obligation bonds. The Authority's debt as of June 30, 2008 was $616.5 million including $465.8 million of bonds issued in March 2006 to finance the Convention Center and payable from a portion of a hotel room tax.

Electric Power Authority. The Authority owns and operates the island's electric system. The capital improvement program for the five-year period ending June 30, 2012 is estimated to cost approximately $2.3 billion and will be financed primarily by borrowed funds, supplemented by internally generated funds. The Authority's bonded debt consists of Power Revenue Bonds, secured by a lien on net revenues of the electric system. As of June 30, 2008, the Authority's total debt was $7.3 billion, including $6.2 billion of bonds outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). As a means of reducing its dependency on oil, the Authority has entered into long-term power purchase agreements with the operators of two co-generation plants that use fuels other than oil. Currently, these two co-generation plants provide approximately 27% of the Authority's energy needs.

Health Insurance Administration was created in 1993 to negotiate and contract for the provision of comprehensive health insurance coverage for qualifying (generally low income) Puerto Rico residents. Under this system, the government selects, through a bidding system, one private health insurance company in each of eight designated regions of the island and pays such insurance company the insurance premium for each eligible beneficiary within such region. The health insurance system covers the entire island, and approximately 1.5 million persons were covered by the system during fiscal year 2008.

In January 2006, the Commonwealth entered into various contracts with several Medicare Advantage Organizations for the provision of health coverage to approximately 200,000 eligible beneficiaries. Pursuant to these agreements, the Commonwealth pays each Medicare Advantage Organization a premium difference to cover services not included in their contracts with the Center for Medicaid and Medicare Services.

The estimated total cost of the health insurance program for fiscal year 2008 was $1.67 billion, compared to $1.59 billion for fiscal year 2007 and $1.56 billion for fiscal year 2006. For fiscal year 2008, the General Fund covered $1.07 billion of the total cost of the health insurance program; the remaining $604 million were paid from federal, municipal and other sources. The fiscal year 2009 budget estimates the cost of the health insurance program at $1.79 billion, of which the General Fund is expected to cover $1.0 billion, while the remaining $793 million will be paid from federal, municipal and other sources. The health insurance program projects a $400 million deficit for fiscal year 2009. The Health Insurance Administration's deficit for fiscal year 2008 was approximately $60 million. See *Budget of the Commonwealth of Puerto Rico*.

Highways and Transportation Authority. The Authority is responsible for highway construction in Puerto Rico. Such construction is financed by debt (interim notes and revenue bonds), revenues of the Authority, and federal and Commonwealth grants. Debt service on the Authority's revenue bonds constitutes a first lien on its gross revenues, which consist currently of all the proceeds of the tax on gasoline, one-half of the proceeds of the tax on gas oil and diesel oil, all the proceeds of the excise taxes on crude oil, unfinished oil and derivative products, up to $120 million per fiscal year, highway toll revenues and the gross receipts of $15.00 per vehicle per year from certain motor vehicle license fees. Such revenues (except for toll revenues) may be applied first to the payment of debt service on general obligation bonds and notes of the Commonwealth and to payments required to be made by the Commonwealth under its guarantees of bonds and notes, to the extent that no other revenues are available for such purpose. The Commonwealth has never applied such revenues for such payment. As of June 30, 2008, the Authority's total debt was $7.1 billion, including $6.4 billion in outstanding bonds.

The Authority has completed the first phase of a new mass transit system, known as Tren Urbano, to serve a portion of metropolitan San Juan. It was constructed under several design/build contracts and is being privately operated under a five-year contract with an additional five-year option at the Authority's election. The cost of the first phase was $2.25 billion, which cost was financed by federal Transit Administration grants, other federal funding sources and the Authority's own resources, including revenue bonds. Tren Urbano commenced operations in June 2005.

The Authority is a party to a concession agreement under which a private company designed, constructed and currently is operating a toll bridge spanning the San José Lagoon. The toll bridge was financed with special facility revenue bonds of the Authority, payable by the private operator of the bridge principally from toll revenues. The concession is for a term of 35 years, subject to earlier termination or extension. The bridge opened for traffic in February 1994. In certain circumstances described in the concession agreement, including where toll revenues are insufficient to generate certain rates of return to the private operator, the private operator may require the Authority, among other things, to assume the operator's obligations with respect to the special facility revenue bonds. Some of those circumstances, including low toll revenues, exist at this time, but the Authority does not currently anticipate that the operator will exercise its remedy against the Authority.

Industrial Development Company participates in the Commonwealth-sponsored economic development program by providing physical facilities, general assistance, and special incentive grants to manufacturers. The Company was merged with the Economic Development Administration in January 1998. Rentals derived from the leasing of specified facilities of the Company are pledged to the payment of the Company's revenue bonds. As of June 30, 2008, the Company's total debt was $352.8 million. The Company restructured its operations in order to allow it to react quickly to changing business situations. Part of this restructuring included a significant reduction in the number of its employees.

Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority was created to finance (through the issuance of its revenue bonds) industrial, tourist, educational, medical, and environmental control facilities in Puerto Rico for the use of private companies, non-profit entities, or government agencies. The bonds are payable solely from payments to be made to AFICA by such private companies, non-profit entities, or government agencies, and do not constitute a debt of the Commonwealth or any of its other public corporations or municipalities. As of June 30, 2008, approximately $1.6 billion of AFICA's bonds were outstanding.

Infrastructure Financing Authority was created to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other public corporations, governmental instrumentalities, political subdivisions and municipalities (collectively, "Benefited Entities") authorized to develop infrastructure facilities and to establish alternate means for financing those facilities. The Authority is authorized to issue bonds and provide loans, grants and other financial assistance for the construction, acquisition, repair, maintenance and reconstruction of infrastructure projects by Benefited Entities. The Authority oversees the Puerto Rico Infrastructure Fund, which is funded with annual fixed amounts from the first proceeds of federal excise taxes imposed on rum and other articles produced in Puerto Rico and sold in the United States which are transferred to Puerto Rico pursuant to the United States Internal Revenue Code of 1986, as amended. Currently, this amount is $90 million through fiscal year 2009 and will then increase to $117 million annually through fiscal year 2052. Rum is the only article currently produced in Puerto Rico subject to federal excise taxes, the proceeds of which are required to be returned to the Treasury. The Authority is using these amounts to provide financial support for various infrastructure and other projects. As of June 30, 2008, the Authority's total debt was $1.9 billion.

The Authority will invest approximately $405 million in new infrastructure projects in connection with the holding of the Central American and Caribbean Games in Mayagüez, Puerto Rico, in 2010. In September 2006, the Authority issued $469.8 million of bonds to finance these and other infrastructure projects.

Municipal Finance Agency is the municipal "bond bank" for Puerto Rico. The Agency is authorized to issue bonds to purchase general obligation bonds and notes of Puerto Rico municipalities and to fund a debt service reserve. Debt service on the Agency's bonds is payable from debt service payments on municipal bonds and notes held by the Agency and from the debt service reserve, including investment income thereon. The Commonwealth has agreed to pay such amounts to the debt service reserve as may be necessary to maintain it at its required level, subject to appropriation by the Legislative Assembly, which appropriation is authorized but not legally required to be made. To date no such payments have been required. As of June 30, 2008, the Agency had $1.4 billion of bonds outstanding.

Port of the Americas Authority. Port of the Americas Authority is responsible for the development and operation of the Port of the Americas (the "Port"), a deep draft port on the south coast of Puerto Rico. The Authority is authorized to issue bonds guaranteed by the Commonwealth in a maximum aggregate principal amount of $250 million. The proceeds from these bonds will be used to continue the development of the Port. Currently, GDB is authorized to purchase bonds of the Authority in an aggregate principal amount not to exceed $250 million.

As of June 30, 2008, GDB held approximately $112.4 million of the Authority's outstanding bonds, which are guaranteed by the Commonwealth.

Ports Authority. The Authority owns and operates the major airport and seaport facilities in Puerto Rico. The Authority derives revenues from a variety of sources, including charges on airplane fuel sales, air terminal space rentals, landing fees, wharfage, dockage and harbor fees, and rentals for the lease of property and seaport equipment. As of June 30, 2008, the Authority had $685.5 million in debt.

Public Buildings Authority is authorized to construct, purchase or lease office, school, health, correctional and other facilities for lease to departments, public corporations, and instrumentalities of the Commonwealth. Bonds that have been issued by the Authority to finance such facilities (through retirement of interim notes or otherwise) are payable from lease payments, which are largely derived from legislative appropriations and are secured by the Commonwealth's guaranty. The Authority is authorized by law to have outstanding at any one time up to $3.325 billion of bonds guaranteed by the Commonwealth. As of June 30, 2008, $3.099 billion of such bonds of the Authority were outstanding (not including accretion of interest from the respective issuance dates on capital appreciation bonds). As of June 30, 2008, Public Building Authority's line of credit with GDB had an outstanding balance of $75 million.

Special Communities Perpetual Trust. The Special Communities Perpetual Trust, a public corporation, is an irrevocable and permanent trust. The Trust's principal purpose is to fund development projects which address the infrastructure and housing needs of underprivileged communities. GDB has made a special capital contribution to the Special Communities Perpetual Trust of $500 million and provided the Trust with a $500 million, non-revolving, line of credit. The amounts transferred by GDB were deposited in two investment accounts held by GDB for the benefit of the Special Communities Irrevocable Trust, of which $766.0 million had been disbursed to the Trust as of June 30, 2008. As of June 30, 2008, the Special Communities Perpetual Trust's line of credit with GDB had an outstanding balance of $376.1 million. The line of credit is payable from legislative appropriations.

Telephone Authority was created in July 1974 when the Commonwealth purchased the Puerto Rico Telephone Company ("PRTC") from International Telephone and Telegraph Corporation. PRTC operates the principal telephone system in Puerto Rico.

In 1999, the Telephone Authority sold a controlling interest in PRTC to a consortium led by a predecessor of Verizon Communications, Inc ("Verizon"). The net proceeds of $1.2 billion, after PRTC's outstanding debt was retired and certain employee benefits were paid, was deposited into the Infrastructure Development Fund held by the Infrastructure Financing Authority. In 2002, Verizon exercised an option to purchase additional shares from the Telephone Authority for $172 million, leaving the Authority with a 28% ownership interest in PRTC. In 2007, the Authority sold its remaining interest in PRTC to a subsidiary of América Móvil, S.A. de C.V. for $529 million, the proceeds from which were transferred to the Employees Retirement System of the Commonwealth.

University of Puerto Rico (the "University"), with approximately 63,682 students in academic year 2007-2008, is by far the largest institution of higher education on the island.

Government appropriations are the principal source of University revenues, but additional revenues are derived from tuition, student fees, auxiliary enterprises, interest income, federal grants, and other sources. University capital improvements have been financed mainly by revenue bonds. As of June 30, 2008, the University's total debt was $619.2 million, including $585 million of outstanding revenue bonds.

In 2000, AFICA issued its $86,735,000 Educational Facilities Revenue Bonds, 2000 Series A (University Plaza Project) for the purpose of financing the construction of additional student housing and parking and office space for the University. The project was built, is being operated by Desarrollos Universitarios, Inc., a Puerto Rico not-for-profit corporation, and is leased to the University for a term equal to the term of the bonds with University lease payments being sufficient to pay debt service on said bonds as they become due. These bonds are not included in the University's total debt or outstanding revenue bonds set forth in the prior paragraph.

Other public corporations (not described above) have outstanding debt in the aggregate amount of $1.9 billion as of June 30, 2008. Debt service on $759 million of such outstanding debt is being paid from legislative appropriations and sales tax receipts. The Commonwealth is not, however, obligated to make any such appropriations. Additional legislative appropriations are made to enable certain of such corporations to pay their operating expenses.

INSURANCE MATTERS

Government-owned property is insured through policies obtained by the Secretary of the Treasury and through self-insurance, except for property owned by the Electric Power Authority and PRASA, whose properties are insured through arrangements and policies obtained by the respective Authorities. Personal injury awards against the Commonwealth are limited by law to $150,000 per occurrence.

RETIREMENT SYSTEMS

General. Public employees of the Commonwealth and its instrumentalities are covered by five retirement systems: the Employees Retirement System, the Puerto Rico System of Annuities and Pensions for Teachers (the "Teachers Retirement System"), the Commonwealth Judiciary Retirement System (the "Judiciary Retirement System"), the Retirement System of the University of Puerto Rico (the "University Retirement System"), and the Employees Retirement System of Puerto Rico Electric Power Authority (the "Electric Power Authority Retirement System").

The University Retirement System and the Electric Power Authority Retirement System apply to employees of the University of Puerto Rico and Electric Power Authority, respectively. The Commonwealth is not required to contribute directly to those two systems, although a large portion of University revenues is derived from legislative appropriations.

Covered Employees. The Teachers Retirement System covers public school teachers and certain private school teachers, as well as teachers working in administrative positions. Substantially all active teachers of the Commonwealth's Department of Education are covered by Act No. 91 of March 29, 2004 which superseded Act No. 218 of 1951. The new law establishes that: (i) the Teachers Retirement System's active employees as of March 29, 2004 (not public school teachers or other Education Department employees) have the option to participate in the Teachers Retirement System or in the Employees Retirement System; (ii) persons hired by Teachers Retirement System after the approval of the new law may only become members of the Teachers Retirement System, (iii) active teacher employees of the Department of Education are members of the Teachers Retirement System, and (iv) licensed teachers working in private schools or other educational organizations may elect to become members of the Teachers Retirement System as long as the required employer and employee contributions are satisfied. The Judiciary Retirement System covers judges, and the Employees Retirement System covers all other employees of the Commonwealth, its municipalities and instrumentalities. As of April 31, 2008, the total number of participants, including active participants and retirees, in the three systems was as follows: Employees Retirement System, 278,234; Teachers Retirement System, 77,500; and Judiciary Retirement System, 685. The three systems are financed by contributions made by employers (the Commonwealth, public corporations, and municipalities) and employees, and investment income.

Funding Requirements. The central government is responsible for approximately 64% of total employer contributions to the Employees Retirement System, and the other 36% is the responsibility of public corporations and municipalities. The central government is also responsible for 100% and 99% of total employer contributions to the Judiciary and Teachers Retirement Systems, respectively. Retirement and related benefits provided by the systems and required contributions to the systems by employers and employees are determined by law rather than by actuarial requirements. For the Employees Retirement System, required employer contributions are 9.275% of applicable payroll. Required employee contributions for the Employees Retirement System vary according to salary and how the individual employee's retirement benefits are coordinated with social security benefits. For the Judiciary Retirement System, required contributions are 20% of applicable payroll for the employer and 8% for the employees. For the Teachers Retirement System, required contributions are 8.5% of applicable payroll for the employer and 9.0% for the employees.

Actuarial Valuation of Employees and Judiciary Retirement System. According to the most recent actuarial valuation of the Employees Retirement System and Judiciary Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2005, the total pension benefit obligations for the Employees Retirement System and Judiciary Retirement System were $12.284 billion and $174 million, respectively. The unfunded pension benefit obligations of the Employees Retirement System and Judiciary Retirement System for the same period were $9.956 billion and $104 million, respectively, representing funding ratios of 19% and 40%, respectively. Any amounts receivable from the Commonwealth with respect to benefits under special benefits laws (discussed below) are considered in the actuarial evaluation process to determine the unfunded pension benefit obligation of the Employees Retirement System to the extent receivables are recognized as such by the Employees Retirement System. The June 30, 2005 actuarial valuation was completed in accordance with the "Projected Unit Credit" method and assumed an investment return of 8.5% per year and a salary increase of 5% per year. Insofar as the statutorily mandated annual deposit to the Employees Retirement System and Judiciary Retirement System is insufficient to cover the actuarial pension benefit obligation, the unfunded pension benefit obligation of the System will continue to increase in the short term, and additional funding from the Commonwealth may ultimately be necessary to cover such unfunded obligation.

Actuarial Valuation of Teachers Retirement System. According to the most recent actuarial valuation of the Teachers Retirement System submitted by a firm of independent consulting actuaries, as of June 30, 2007 the accrued actuarial liability of the system was $7.756 billion and the value of its assets amounted to $3.163 billion, representing a funding ratio of 41%, and the resulting unfunded accrued liability was $4.593 billion. The actuarial valuation assumed an investment return of 8%, yearly salary increases of 3.5%, employee and employer contributions of 9% and 8.5%, respectively, an inflation rate of 2.5%, and a remaining amortization period of 30 years for the unfunded accrued liability. Under the same above assumptions, but without taking into account benefits paid under special benefits laws (described below) and does not include the obligation with respect to the prospective payments under special benefits laws because these are not obligations of the Teachers Retirement System, and the funding for such benefits will originate from the Commonwealth's General Fund, as of June 30, 2007, the accrued actuarial liability was $7.227 billion and the value of its assets amounted to $3.163 billion, representing a funding ratio of 44%, and the resulting unfunded accrued liability was $4.064 billion. Insofar as the statutorily mandated annual deposit to the Teachers Retirement System is insufficient to cover the actuarial pension liability, the unfunded pension benefit obligation will continue to increase, and additional funding from the Commonwealth may ultimately be necessary to cover such unfunded liability.

Special Benefits. Various special benefits laws enacted in previous years provided for additional benefits for the Employees Retirement System, Teachers Retirement System, and Judiciary Retirement System. Specifically, in the case of the Employees Retirement System, Act No. 10 of May 21, 1992 provided for special benefit increases of 3% every three years. The first 3% increase was granted to retirees who had been receiving their annuities for three or more years as of that date. The second 3% increase was granted to retirees who had been receiving their annuities for three or more years as of January 1, 1995. This increase is being financed by additional contributions from the employers. The third 3% increase was granted to retirees who had been receiving their annuities for three or more years as of January 1, 1998. This third increase is being partially funded with additional contributions from some of the employers. In June 2001, the Legislative Assembly approved a fourth 3% increase, effective as of January 1, 2001, in post-retirement annuity payments granted on or prior to January 1, 1998. This increase will be funded by the General Fund for retirees who were employees of the central government and by municipalities and public corporations for retirees who were their employees. In June 2003, the Legislative Assembly approved a fifth increase of 3% in post retirement benefits effective January 1, 2004. This increase will also be funded by the General Fund for retirees who were employees of the central government and by municipalities and public corporations for retirees who were their employees. In June 2007, the Legislative Assembly approved a sixth increase of 3% in post retirement benefits effective January 1, 2007. This increase will also be funded by the General Fund for retirees who were employees of the central government and by municipalities and public corporations for retirees who were their employees. Subsequent increases will depend upon the express approval of the Board of Trustees of the Employees Retirement System and the Legislative Assembly, and must provide a funding source. In the case of the Judiciary Retirement System, Act No. 41 of June 13, 2001 provided a 3% special benefit increase in annuity payments, commencing on January 1, 2002 and every three years thereafter, to retirees who have been receiving their annuities for three or more years as of that date. This increase will be funded by the General Fund.

The Teachers Retirement System is seeking reimbursement from the Commonwealth's Office of Management and Budget in the amount of $119 million for special benefits paid by the System to its beneficiaries through June 30, 2004 pursuant to special benefit laws enacted by the Legislative Assembly. The Teachers Retirement System's interpretation of these special benefit laws, to the effect that the Commonwealth is required to reimburse the Teachers Retirement System for such special benefits paid, is being disputed by OMB. This dispute is currently under inter-agency arbitration proceedings. The Employees Retirement System is also seeking reimbursement from the Commonwealth (in connection with other special benefits laws applicable to its beneficiaries) in the amount of $73.9 million, representing cumulative benefits paid to beneficiaries through June 30, 2005. OMB believes that the basis of the claims from the Employees Retirement System is valid but that the amounts claimed remain to be verified and reconciled.

Amendments to Employees Retirement System. In February 1990, the organic act of the Employees Retirement System was amended to reduce the future pension liabilities of the Employees Retirement System. Among other provisions, the legislation increased the level of contributions to the Employees Retirement System and limited the retirement benefits for new employees by increasing the length of employment required for the vesting of certain benefits and reducing the level of benefits in the case of early retirement. The legislation also reduced the level of occupational disability benefits and death benefits received by new employees.

In 1999, the organic act of the Employees Retirement System was further amended to change it, prospectively, from a defined benefit system to a defined contribution system. This amendment provides for the establishment of an individual account for each employee hired by the Commonwealth after December 31, 1999 and for those current employees who elect to transfer from the existing defined benefit system. The individual account of each current employee is credited initially with an amount equal to his aggregate contributions to the Employees Retirement System, plus interest. Current employees who did not elect to transfer to the new defined contribution system will continue accruing benefits under the current defined benefit system. The individual account of each participant of the new defined contribution system is credited monthly with the participant's contribution and is credited semiannually with a rate of return based on either of two notional investment returns. Such accounts are not credited with any contribution by the employer. Instead, employer contributions will now be used completely to reduce the accumulated unfunded pension benefit obligation of the Employees Retirement System.

The law approving the sale of a controlling interest in PRTC to a consortium led by GTE International Telecommunications Incorporated (subsequently acquired by Verizon Communications Inc.) (see *Public Corporations* – Other Public Corporations – Telephone Authority) provides that any future proceeds received by the government from the sale of its then remaining 43% stock ownership in PRTC will be transferred to the Employees Retirement System to reduce its accumulated unfunded pension benefit obligation. In January 2002, Verizon exercised its option to purchase an additional 15% of the stock of PRTC for $172 million. The proceeds of the sale were transferred to the Employees Retirement System. The

Commonwealth has decided to exercise its “tag along” rights in connection with the sale by Verizon of its PRTC stock to Sercotel. As a result of the exercise of such rights, the Employees Retirement System received in June 2007 approximately $529 million from the sale of its remaining stock participation in PRTC.

Historically, the Employees Retirement System achieved a return on investment of less than 2% on the PRTC stock, while the average return of the other assets in its portfolio was approximately 10.8%. In order to improve its funding ratio and address its continuing cash shortfalls, the Employees Retirement System intends to use the proceeds received from the sale of the PRTC stock to acquire other, higher-yield assets, such as personal and mortgage loans to participants of the System.

Cash Flow Shortfalls. The Employees Retirement System’s disbursements of benefits during fiscal years 2003 through 2007 exceeded contributions and investment income for those years. The cash shortfall for fiscal year 2003 was covered with a portion of the proceeds from the sale to Verizon of the 15% stock ownership in PRTC and a loan received from the Department of the Treasury. The cash shortfall for fiscal year 2004 was covered with a loan received from the Department of the Treasury. Balances owed to the Department of the Treasury and other pending working capital needs through fiscal year 2005 were refinanced through a repurchase agreement with a financial institution in an amount of $138 million collateralized with the assets of the Employees Retirement System. The cash shortfall for fiscal year 2006 was approximately $70 million. This shortfall was covered with a line of credit provided by a private financial institution and collateralized with the assets of the Employees Retirement System. There was no cash shortfall for fiscal year 2007 on account of the receipt of the proceeds from the sale of the PRTC stock. Also with these proceeds the Employees Retirement System paid off the balances of the 2005 repurchase agreement and the 2006 line of credit used to cover the respective year’s cash shortfalls.

Efforts to Address Cash Flow Shortfall and Improve Funding Ratio. The Employees Retirement System anticipates that its future cash flow needs for disbursement of benefits to participants are likely to exceed the sum of the employer and employee contributions received and its investment and other recurring income. The Employees Retirement System is also evaluating other measures to improve its cash flows and funding ratio. Some of these measures include, but are not limited to, the establishment of a maximum salary to calculate pension benefits, aggressive collection efforts with respect to employer contributions owed by the Commonwealth, the municipalities and public corporations, and the transfer to the Employees Retirement System of any amounts remaining in the Children’s Trust after payment of all the outstanding bonds. See “Tax Reform” under *Puerto Rico Taxes, Other Revenues, and Expenditures*.

In addition, the Employees Retirement System is currently undertaking a series of financings to increase the System’s funding ratio and reduce its unfunded pension benefit obligation. The financings involve the issuance by the Employees Retirement System of debt secured by a pledge of future employer contributions over the next 50 years. All net cash generated by these financings is deposited into the Employees Retirement System trust and invested along with its other assets as described above. As of June 30, 2008, the Employees Retirement System had issued three series totaling approximately $3.0 billion of its Senior

Pension Funding Bonds. The Employees Retirement System expects that additional financing will be undertaken during fiscal year 2009 and subsequent years.

The following tables present the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the Employees Retirement System and the Judiciary Retirement System for the fiscal years 2005, 2006 and 2007 and as of the period ended April 30, 2008 and the Statement of Plan Net Assets and Statement of Changes in Plan Net Assets of the Teachers Retirement System for the fiscal years 2005, 2006 and 2007.

The Commonwealth of Puerto Rico
Employees' Retirement System
Statements of Plan Net Assets
As of June 30, 2005, 2006, 2007 and April 2008

	2008*	2007	2006	2005
ASSETS				
Cash and Investments:				
Cash and Cash Equivalents	$ 82,702,029	$ 41,364,614	$ 27,849,344	$ 13,196,092
Cash Deposited with GDB				
Unrestricted	240,831,359	266,633,121	25,777,388	29,177,311
Restricted	2,482,775	2,309,996	2,156,259	1,577,829
Restricted Cash Bonds	185,274,644			
Total Cash	511,290,808	310,307,731	55,782,991	43,951,232
Securities lending, collateral invested				
Marketable Securities:				
Notes and Bonds	89,820,082	149,638,587	6,666,938	20,786,293
Notes and Bonds Investment on Bonds	914,648,389			
Stocks	1,613,444,341	1,693,143,613	1,376,901,021	1,200,131,525
Stocks Investment on Bonds	78,912,370			
Master Repo	-	-	148,158,416	145,654,230
Investment on Bonds				
Alternative investment	44,967,491	47,784,185	41,609,142	41,243,583
Total Cash and Investments	2,741,792,671	1,890,566,384	1,573,335,517	1,407,815,632
LOANS TO PLAN MEMBERS				
Mortgage	110,985,023	107,680,038	96,542,018	82,294,726
Personal	759,639,170	440,167,352	406,882,638	362,362,930
Cultural Trips	32,932,905	28,933,093	24,894,132	20,589,837
PEC	556,280	533,107	232,805	
Total Loans to Plan Members	904,113,378	577,313,590	528,551,593	465,247,492
Investment in PRTA Holdings	-	-	495,318,231	486,080,000
Total cash, investments and loans to Plan Members	4,157,196,857	2,778,187,705	2,652,988,331	2,403,094,357
RECEIVABLES:				
Employers	100,959,147	117,420,124	43,343,256	34,655,582
General Fund of the Gov	2,236,491	4,614,730	10,404,858	21,462,669
The Commonwealth of PR Jud	11,994,377	5,113,316	3,160,552	1,376,261
Investment Sales	7,246,055	2,469,752	1,278,609	2,090,013
Investment Sales on Bonds	10,756,469			
Accrued Interest	2,943,174	3,119,114	2,384,775	2,208,772
Dividend Receivable			23,720,395	
Other	25,540,027	4,526,995	23,575,164	21,895,683
Total Receivables	161,675,741	137,264,031	107,867,610	83,688,980
PROPERTY:	6,746,510	7,100,738	7,694,169	8,410,790
OTHER ASSETS	6,811,021	7,371,332	7,591,753	7,764,041
Construction in Progress	2,937,574	1,375,153		
Prepaid Bond Cost	20,424,843			
Total assets	4,355,792,546	2,931,298,959	2,776,141,864	2,502,958,166
LIABILITIES				
Book overdraft	1,035,903	1,566,248		
Short Term Obligation		-	139,074,002	138,000,000
Repurchase Obligation	-		1,245,157	
Escrow Funds to Plan Members and Guarantee Insurance	9,400,222	8,913,975	8,432,615	20,365,814
Investment Purchases	6,597,654	2,172,417	1,179,373	2,078,940
Investment Purchases on Bonds	7,858,135			
Accounts Payable and Accrued Liabilities	7,754,239	10,124,944		
Line of Credit	-		60,000,000	
Bonds Payable	1,587,146,950			
Other Liabilities	53,358,043	17,022,008	24,879,755	14,641,925
Account Payable and Accrued Liabilities	7,754,239			
Total Liabilities	1,673,151,146	39,799,592	209,931,146	160,444,754
Net Assets Held in trust for Pension Benefits	$ 2,682,641,399	$ 2,891,499,366	$ 2,566,210,717	$ 2,342,513,412

The Commonwealth of Puerto Rico
Employees' Retirement System
Statements of Changes in Plan Net Assets
As of June 30, 2005, 2006, 2007 and April 2008

	2008*	2007	2006	2005
ADDITIONS:				
Contributions:				
Employer	$ 316,165,044	$ 374,394,089	$ 398,521,341	$ 374,823,631
Participating employees	287,080,306	338,791,075	342,829,957	332,376,008
Special	-	17,000,000	16,684,000	14,730,754
Retirement Benefits	37,903,698	69,096,992		
Total Contributions	641,149,048	799,282,156	758,035,298	721,930,393
Investment Income:				
Realized Gain or Loss	7,769,313	74,304,308	33,022,935	36,418,166
Realized Gain or Loss Bonds	13,069,055			
Unrealized Gain or Loss	(99,172,874)	289,880,852	156,491,728	150,225,279
Unrealized Gain or Loss Bonds	12,876,521			
Dividend Income	4,254,588	14,494,145	49,938,626	19,111,465
Interest Income	88,044,417	68,230,539	63,485,695	49,917,102
Interest Income Bonds	8,108,308			
Total	34,949,327	446,909,843	302,938,983	255,672,013
Less Investment Expense	(601,067)	(12,940,327)	(10,122,844)	(3,749,348)
Insurance Premium	5,615,032	2,440,600	14,491,851	
Other Income	8,406,795	17,430,687	8,495,523	7,924,599
Net Investment Income	48,370,088	453,840,802	315,803,513	259,847,264
Total Additions	689,519,136	1,253,122,959	1,073,838,811	981,777,657
DEDUCTIONS:				
Annuities	804,247,435	800,786,513	772,647,291	713,813,825
Special		17,000,000	16,684,000	14,730,754
Death Benefits	15,731,903	13,871,712	14,983,647	10,894,650
Refunds:				
Employers	30,626,763	5,295,940	1,666,200	1,734,049
Participating Employees	2,752,232	28,008,506	20,707,399	17,946,630
Personal Loans Adjustment			1,658,221	
Loans Premium Death Benefits	513,727	2,117,527	1,215,515	
Other Expenses	2,096,139	6,666,080		
Administrative Expenses	26,217,738	29,208,275	30,817,063	36.228,159
Cost of Bonds	16,191,165			
Net Adjustment in the conversion to a new loan application				
Total Deductions	898,377,103	902,954,554	860,379,336	795,348,067
Net Increase	(208,857,967)	350,168,405	213,459,474	186,429,589
Net Assets Restated per Auditors				
Net Assets Held in Trust for Pension Benefits:				
Beginning of the Year	2,891,499,366	2,541,330,962	2,327,871,487	2,141,441,898
End of Year	$ 2,682,641,399	$ 2,891,499,366	$ 2,541,330,962	$ 2,327,871,487

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statements of Plan Net Assets
As of June 30, 2005, 2006, 2007 and April 2008

	2008*	2007	2006	2005
ASSETS				
Cash and Investments:				
Cash and Cash Equivalents	$ 2,218,059	$ 2,734,805	$ 1,599,240	$ 1,803,777
Cash Deposited with GOB				
Unrestricted	577,586	197,202	179,194	921,430
Restricted	432	192	781	872
Total Cash	2,796,077	2,932,200	1,779,216	2,726,079
Receivables:				
Accreted Interest	275,613	237,222	249,583	252,862
Investment Sales	478,655	178,936	561,488	102,365
Other	117,295	85,821	44,647	48,658
Total receivables	871,563	501,979	855,719	403,886
Marketable Securities:				
Notes and Bonds	22,549,724	20,727,595	19,821,535	20,031,133
Stocks	65,184,565	68,654,437	56,107,513	49,360,325
Mortgage Notes Acquired from Third Parties		-	-	-
Total marketable securities	87,734,289	89,382,032	75,929,048	69,391,458
LOANS TO PLAN MEMBERS				
Mortgage	10,093	17,336	34,311	43,524
Personal	411,260	194,749	191,032	173,292
Cultural Trips	39,895	44,097	48,642	34,454
Total Loans to Plan Members	461,247	256,183	273,985	251,270
Total cash, investments and loans to plan members	91,863,176	93,072,393	78,837,968	72,772,692
LIABILITIES				
Book overdraft	2,905,562	5,414,533	1,902,450	827,661
Due to the Employees' Retirement System of the Government of Puerto Rico	11,994,377	5,113,316	3,160,552	1,376,261
Escrow Funds to plan Members and Guarantee Insurance	55,685	52,728	52,391	130,023
Investment Purchases	381,158	180,411	67,271	123,315
Other Liabilities	1,632,036	838,352	806,719	518,647
Total Liabilities	16,968,818	11,599,341	5,989,382	2,975,907
Net Assets Held in trust for Pension Benefits	$ 74,894,357	$ 81,473,053	$ 72,848,586	$ 69,796,786

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statements of Changes in Plan Net Assets
As of June 30, 2005, 2006, 2007 and April 2008

	2008*	2007	2006	2005
ADDITIONS:				
Contributions:				
Employer	$ 5,544,047	$ 6,631,596	$ 6,726,886	$ 6,469,433
Participating employees	2,499,253	2,828,493	2,959,728	2,775,269
Special				
Total Contributions	8,043,301	9,460,089	9,686,614	9,244,701
Investment Income:				
Realized Gain or Loss	813,104	1,484,283	1,188,568	1,997,589
Unrealized Gain or Loss	(4,312,498)	10,954,303	4,629,804	2,247,722
Dividend Income	208,138	224,426	205,233	206,324
Interest Income	1,317,749	1,446 821	1,219,231	1,158,023
Total	(1,973,507)	14,109,833	7,242,836	5,609,658
Less Investment Expense	(3,523)	(192,243)	(278,587)	(190,134)
Other Income	528		1,112	3,646
Net Investment Income	(1,976,502)	13,917,590	6,965,360	5,423,170
Total Additions	6,066,798	23,377,679	16,651,974	14,667,871
DEDUCTIONS:				
Annuities	11,886,582	133,460,710	12,273,392	11,229,901
Refunds:				
Employees	45,823			135,075
Participating Employees	31,585	38,194	129,975	124,296
Administrative Expenses	681,505	1,254,303	1,196,807	1,232,061
Net Adjustment in the conversion to new loans application				
Total Deductions	12,645,494	14,753,212	13,600,174	12,721,333
Net Increase	(6,578,696)	8,624,467	3,051,801	1,946,538
Net Assets Held in Trust for Pension Benefits:				
Beginning of the Year	81,473,053	72,848,586	69,796,786	67,850,248
End of Year	$ 74,894,357	$ 81,473,053	$ 72,848,586	$ 69,796,786

The Commonwealth of Puerto Rico
Annuities and Pensions for Teachers
Statement of Plan Net Assets*
As of June 30 of the Indicated Years
(in thousands)

	2007	2006	2005
ASSETS			
Cash:			
Cash and cash equivalents	$ 33,542	$ 53,515	$ 79,017
Cash with fiscal agent	-	-	2,853
Cash restricted	-	1,717	1,595
Cash deposited with Government Development Bank for Puerto Rico	3,123	2,993	3,536
Total Cash	36,665	58,225	87,001
Investments, at fair value:			
Bonds and notes	468,452	463,474	257,030
Stocks	2,218,033	1,886,625	1,833,168
Total investment at fair value	2,686,485	2,350,099	2,090,198
Other investments:			
Mortgage notes acquired from third parties		-	-
Private equity investments	46,686	46,215	44,747
Total investments	2,733,171	2,396,314	2,134,945
Loan to plan members:			
Mortgage	102,684	104,830	109,605
Personal	260,066	246,074	234,335
Cultural trips	1,371	1,429	1,338
Total loans to plan members	364,121	352,333	345,278
Total investments and loans	3,133,957	2,806,872	2,567,224
Accounts receivable:			
Receivable for investments sold	12,242	12,163	10,516
Accrued interest and dividends receivable	6,312	6,371	4,449
Other	14,640	14,932	2,593
Total accounts receivable	33,194	33,466	17,558
Property and equipment, net	25,890	25,665	26,206
Other assets	700	691	600
Total Assets	3,193,741	$2,866,694	$2,611,588
LIABILITIES			
Investments purchased	11,258	$11,422	$14,262
Cash overdraft in cash with fiscal agent	5,619	13,949	-
Accounts payable	4,152	3,043	3,768
Obligation under capital lease	35	57	78
Accrued expenses	4,270	4,289	4,314
Line of credit	4	4	4
Escrow fund of mortgage loans and guarantee insurance reserve for loans to plan members	4,916	5,988	6,069
Bonds payable	-	20,430	21,285
Other liabilities	567	625	669
Total liabilities	31,021	59,807	50,449
Net Assets Held in Trust for Pension Benefits	$3,162,720	$2,806,887	$2,561,139

* Totals may not add due to rounding.

The Commonwealth of Puerto Rico
Annuities and Pensions for Teachers
Statement of Changes in Plan Net Assets*
As of June 30 of the Indicated Years
(in thousands)

	2007	2006	2005
ADDITIONS:			
Contributions:			
Participating Employees	$127,809	$ 129,473	$ 131,481
Employer	116,320	119,199	120,887
Contributions transferred from other systems**	12,396	921	-
Special	57,960	61,066	60,853
Total contributions	314,485	310,659	313,221
Investment Income:			
Interest income	65,367	57,899	47,577
Dividend Income	13,654	14,684	20,339
Net appreciation (depreciation) in fair value of investments	406,131	258,182	161,685
	485,152	330,765	229,601
Less investment expense	6,217	5,792	4,986
Net investment income	478,935	324,973	224,615
Other income	1,299	13,085	1,167
Total additions	$ 794,719	$ 648,717	$ 539,003
DEDUCTIONS:			
Benefit paid to participants:			
Annuities and death benefits	364,998	332,425	313,551
Special benefits	45,564	42,837	38,592
Refunds of contributions	5,447	4,135	2,912
Administrative expenses	22,877	22,651	25,804
Total deductions	438,886	402,969	380,859
Net increase in net assets held in trust for pension benefits	355,833	245,748	158,144
Net assets held in trust for pension benefits			
Beginning of year	2,806,887	2,561,139	2,402,995
End of year	$3,162,720	$2,806,887	$2,561,139

* Totals may not add due to rounding.
** This line item was segregated from Refunds of Contributions for 2006 and 2007, but not in 2005.

COMMONWEALTH FINANCIAL STATEMENTS

For fiscal year 2007, the basic financial statements of the Commonwealth were audited by KPMG LLP. KPMG LLP did not audit the financial statements of the Public Buildings Authority capital project fund or The Children's Trust special revenue funds (major funds), and certain activities, funds and component units identified separately in its report. Those financial statements were audited by other independent auditors whose reports were furnished to KPMG LLP, and its opinion on the basic financial statements, insofar as it relates to the amounts included in the basic financial statements pertaining to such activities, funds and component units, is based solely on the reports of the other auditors.

The Comprehensive Annual Financial Report of the Commonwealth ("CAFR") for fiscal year 2007, which includes the basic financial statements of the Commonwealth for fiscal year

2007, was filed by the Commonwealth with each nationally recognized municipal securities information repository (each, a "NRMSIR") in June 2008.

PUERTO RICO TAXES, OTHER REVENUES, AND EXPENDITURES

The Secretary of the Treasury has custody of the funds of the central government and is responsible for the accounting, disbursement and investment of such funds. Central government funds are grouped into three major categories or "types" of funds, as follows: (i) Governmental Fund Types, which include the General, Special Revenue, Debt Service (also referred to herein as Redemption), and Capital Project Funds; (ii) Proprietary Fund Types, which include the Enterprise and Internal Service Funds; and (iii) Fiduciary Fund Types, which include the Trust and Agency Funds. These funds do not include funds of the municipalities, because the municipalities are governmental entities with independent treasuries. The Special Revenue Fund is incorporated into the General Fund for financial reporting purposes (but not for budgetary purposes).

The General Fund is the primary operating fund of the Commonwealth. General Fund revenues are broadly based and include revenues raised internally as well as those from non-Puerto Rico sources. Internal revenues consist principally of income taxes and excise and sales taxes. Revenues from non-Puerto Rico sources are derived from federal excise taxes and customs duties returned to the Commonwealth. The primary expenditures of the Commonwealth through the General Fund are for grants and subsidies, and personal and other services.

Summary and Management's Discussion of General Fund Results

The following table presents the actual revenues and expenditures of the General Fund on a cash basis for fiscal year 2005 through fiscal year 2007, and the preliminary and projected revenues and expenditures for fiscal years 2008 and 2009, respectively.

The amounts shown in the following table as expenditures may be different than those reflected in the budget or in the Commonwealth's financial statements because the table shows only cash disbursements, while the budget includes all authorized expenditures, regardless of when the related cash is actually disbursed. In addition, transfers to the Redemption Fund (used to pay debt service on the Commonwealth's bonds), which are included in the budget under "debt service," are shown as a deduction from total revenues in calculating "adjusted revenues" in the table and are not included under "expenditures." Finally, certain expenditures incurred in excess of budgeted amounts may not be reflected in the table as expenditures to the extent they are paid from reserve funds, such as moneys in the Budgetary Fund. In fiscal year 2005, there were approximately $98.6 million of such expenditures that are not reflected in the table. A discussion of the budget for fiscal years 2008 and 2009 appears below under *Budget of the Commonwealth of Puerto Rico*.

Amounts listed under "Other Income" represent recurring General Fund revenues not appropriately attributable to other revenue line items, such as repayment of General Fund advances to municipalities and government agencies and funds. "Other Expenditures" represent recurring General Fund expenditures not appropriately attributable to other expenditures line items, such as advances to government agencies and municipalities, which advances are to be reimbursed to the General Fund by law. Amounts listed under "Capital Outlays and Other Debt Service" represent debt service on obligations and capital expenditures for which the Legislative Assembly has by resolution agreed to appropriate funds. General Fund revenues, expenditures, and transfers as presented in the table differ from the General Fund revenues, expenditures, and transfers as presented in the financial statements of the Commonwealth, as the latter statements reflect an expanded General Fund entity in accordance with generally accepted accounting principles.

Commonwealth of Puerto Rico
General Fund Revenues, Expenditures, and Changes in Cash Balance
(in thousands)

	2005	2006	2007	2008[*]	2009[+]
Beginning cash balance	$ 108,512	$ 42,933	$ (0)	$ (506,261)	$ (1,192,235)
Revenues from internal sources:					
Income Taxes:					
Individuals	2,885,903	3,087,748	3,071,655	2,793,198	2,770,000
Corporations	1,870,937	1,872,458	2,002,718	1,565,458	1,751,000
Partnerships	3,245	2,787	2,960	1,942	3,000
Withheld from non-residents	612,005	921,260	933,728	1,087,782	1,015,000
Tollgate taxes	22,973	27,396	25,083	21,610	10,000
Interest	10,489	11,536	12,112	13,657	12,000
Dividends	80,398	66,721	138,859	59,770	67,000
Total income taxes	5,485,950	5,989,906	6,187,115	5,543,417	5,628,000
Sales and use tax	-	-	582,560	911,000	977,000
Commonwealth excise taxes:					
Alcoholic beverages	298,235	292,180	279,028	268,095	292,000
Cigarettes	146,527	135,267	132,399	119,124	121,000
Motor vehicles	606,662	533,957	396,667	366,343	414,000
Other excise taxes	740,921	682,477	314,340	110,017	95,000
Total Commonwealth excise taxes	1,792,345	1,643,881	1,122,434	863,579	922,000
Property taxes	3,949	1,106	800	-	
Inheritance and gift taxes	7,129	9,466	4,663	6,600	5,000
Licenses	85,216	91,310	97,610	87,631	96,000
Other:					
Lottery	64,638	62,729	73,014	46,636	59,000
Electronic lottery	68,011	55,212	71,815	105,346	89,000
Miscellaneous non-tax revenues	430,534	431,803[6]	330,064	321,897	335,000
Total Other	563,183	549,744	474,893	473,879	483,000
Total revenues from internal sources	7,937,772	8,285,413	8,470,075	7,886,106	8,111,000
Revenues from non-Commonwealth sources:					
Federal excise taxes[1]	341,166	346,272	377,872	361,827	372,000
Customs	26,731	9,553	14,504	4,796	5,000
Total revenues from non-Commonwealth sources	367,897	355,825	392,376	366,623	377,000
Total net revenues	8,305,669	8,641,238	8,862,451	8,252,729	8,488,000
Other Income (refunds)[2]	(55,409)	76,085	(8,335)	183,917[8]	995,792[9]
Transfers to Redemption Fund[3]	(369,985)	(484,812)	(512,197)	(220,702)	(288,000)
Proceeds of notes and other borrowings[4]	4,925,595	4,115,897[7]	1,872,096	2,520,000	3,000,000
Repayment of notes and other borrowings[5]	(3,909,434)	(3,005,838)	(1,926,273)	(2,585,620)	(3,066,015)
Adjusted revenues	8,896,436	9,342,570	8,287,742	8,150,324	9,129,777
Expenditures:					
Grants and subsidies	3,617,386	3,944,349	3,387,199	2,091,701	3,239,855
Personal services	4,783,567	4,796,382	4,590,962	5,990,308	5,277,864
Other services	389,346	525,377	594,345	426,185	421,386
Materials and supplies	72,411	50,227	79,186	161,924	106,641
Equipment purchases	20,707	19,378	27,965	62,757	45,123
Capital outlays and other debt service	78,598	49,789	21,576	103,423	104,924
Transfers to agencies	-	-	92,770	-	
Other disbursements	-	-	-	-	-
Total expenditures	8,962,015	9,385,503	8,794,003	8,836,298	9,195,792
Adjusted revenues less expenditures	(65,579)	(42,933)	(506,261)	(685,974)	(66,015)
Ending cash balance	$ 42,933	$ (0)	$ (506,261)	$ (1,192,235)	$ (1,258,250)

(*) Preliminary.
(+) Estimated.
(1) Excludes transfers by the Commonwealth to the Conservation Trust Fund and amounts deposited by the Secretary of the Treasury into a separate account for the promotion of Puerto Rico rums in foreign markets.
(2) Consists of net revenues from the General Fund's non budgetary funds plus a reserve for future tax refunds reduced by estimated tax refunds.
(3) Consists of amounts to pay principal of and interest on general obligation bonds and notes of the Commonwealth. Does not include amounts deposited directly into the Redemption Fund from non-General Fund revenues.
(4) Consists of proceeds of borrowing from GDB and proceeds from Commonwealth's Tax and Revenue Anticipation Notes.
(5) Consists of repayments of borrowing from GDB and repayments of Commonwealth's Tax and Revenue Anticipation Notes.
(6) Includes proceeds of $100 million generated by the issuance of the Commonwealth's Public Improvement Refunding Bonds, Series 2006 A, which were privately placed.
(7) Includes $50 million from the Emergency Fund used for operating expenses.
(8) Includes $150 million related to the sale of properties.
(9) Represents collections related to the acceleration of delinquent tax accounts.
Source: Department of the Treasury

Fiscal Year 2009

General Fund Revenues for fiscal year 2009 are projected to be $9.484 billion, of which $8.488 billion are recurring resources and the proceeds from a potential sale of $60 million of bonds to be issued by the Puerto Rico Public Buildings Authority. The remaining almost $1 billion is expected to come from the securitization of delinquent tax accounts. The major revenue categories include: (i) $2.770 billion in individual income taxes, (ii) $1.751 billion in corporate income taxes, (iii) $1.015 billion in non-resident withholdings and (iv) $977 million in sales and use tax.

Estimated expenses for the fiscal year 2009 are $9.484 billion, which represents an increase of $256 million over the original budget for 2008 and an increase of $426 million over the preliminary numbers for 2008. Certain increases in expenditures, related to payroll expenditures and formulaic appropriations, are mandated by law.

Fiscal Year 2008

Preliminary General Fund Revenues for fiscal year 2008 are $8.253 billion, representing a decrease of $340 million, or 4%, from actual revenues for fiscal year 2007. This amount excludes the collection of $269 million from special temporary tax measures in fiscal year 2007. This amount includes $4.358 billion in revenues from individual and corporate income taxes, $1.088 billion from non-resident withholding taxes, $864 million from excise taxes and $911 million of sales tax revenues. The decrease in 2008 collections was principally due to the current recession and high oil prices, which directly affected income and excise taxes. Sales Tax collections met expectations, providing $911 million to the General Fund.

Preliminary General Fund expenses for fiscal year 2008 amounted to $9.057 billion, which is $170 million less than the amount originally estimated. The difference between preliminary revenues and expenses for fiscal year 2008 was covered by federal funds recovery of approximately $287 million and the remaining $504 million by cash management procedures.

Fiscal Year 2007

General Fund total revenues for the fiscal year ended on June 30, 2007 totaled $8.862 billion, $7 million more than the Treasury Department’s revised estimate for that period. This amount includes (i) $933 million in non-resident withholding, (ii) $1.122 billion in excise taxes, (iii) $583 million of sales tax revenues, and (iv) $269 million from special temporary tax measures.

General Fund expenses for fiscal year 2007 were $9.221 billion, which is $267 million below the amount initially budgeted and takes into consideration $160 million in a portion of savings from the 10% budget reserve and $107 in million in health-related expenditure reductions. The $9.221 billion amount does not include $522 million of debt service payments on a portion of the Commonwealth’s outstanding appropriation debt, which debt service was excluded from the budget based on the provisions of Act No. 91 of May 13, 2006, which created the Dedicated Sales Tax Fund to service in part the repayment of such appropriation debt.

The difference between projected revenues and expenses for fiscal year 2007 were covered by a $240 million transfer of funds from Government Development Bank that was originally set aside from General Fund appropriations to cover a portion of debt service payments on the Commonwealth's appropriation debt which set aside is no longer needed on account of the passage of Act No. 91 referred to above. The remaining shortfall (about $100 million) was covered by cash management procedures such as delaying payments to certain vendors for a short period of time (carrying over into fiscal year 2008).

Fiscal Year 2006

General Fund total revenues for fiscal year 2006 were $8.541 billion (approximately $235 million, or 2.8%, more than received in fiscal year 2005). This increase was attributable to increases in income taxes ($504 million, including $309 million in taxes withheld from non-residents), together with decreases in external revenues ($12 million), excise taxes ($147 million), and miscellaneous non-tax revenues ($113 million). The increase in revenues from individual income taxes is mainly attributable to administrative measures and economic activity. The increase in the withholding tax on non-residents includes two extraordinary payments amounting to $200 million.

Total cash expenditures for fiscal year 2006 were $9.596 billion (excluding about $500 million in expenditures that occurred "off budget" for items such as refinanced debt service on general obligation debt and payment of vendor debts from prior years for Public Buildings Authority and subsidy and operational expenses of Agricultural Services and Development Administration) which exceeded original budgeted expenditures by $651 million, attributed mainly to increases in the area of education ($321 million), public safety and protection ($99 million), health ($207 million), and special contributions to pensions ($42 million), and reductions in the area of general government ($4 million), welfare ($3 million), contributions to municipalities ($1 million), and other debt service ($10 million).

The approximately $1.6 billion shortfall was covered by the release of $64 million in reserve funds held at GDB, borrowings from GDB and other sources of about $1.4 billion and about $150 million of "cash management" practices which had the effect of delaying payment of certain expenses until the start of fiscal year 2007. Also, during a two-week period in early May 2006, the Commonwealth was forced to furlough non-essential government workers because it was projected to run out of cash until the above borrowings were implemented in the aftermath of the passage of fiscal and tax reform legislation described below in order to allow the workers to return to work.

Fiscal Year 2005

General Fund total net revenues for fiscal year 2005 were $8.306 billion, representing an increase of $320 million or 4%, from fiscal year 2004 net revenues. This amount excludes proceeds of a loan of $550 million obtained from GDB, which is included as part of "Proceeds of notes and other borrowings." The major changes in revenues from fiscal year 2004 were: (i) increases in total income taxes of $188 million, mainly resulting from increases in income taxes collected from individuals of $165 million and in income taxes collected from corporations of $40 million; (ii) increases in total excise taxes of $99 million; and (iii) net increases in other revenues of $32 million, mainly as a result of an increase in miscellaneous non-tax revenues of $51 million.

Total cash expenditures for fiscal year 2005 were $9.220 billion (excluding $98.6 million covered with funds from the Budgetary Fund), which exceeded budgeted expenditures by $366 million, attributed mainly to increases in the area of education ($300.5 million), public safety and protection ($18.6 million), health ($28.7 million), welfare ($10.2 million), and economic development ($8 million). This amount also excludes approximately $98.6 million of additional expenditures that were not originally budgeted. Various financing transactions were entered into to cover this imbalance.

Tax Reform

Act No. 117 of July 4, 2006 ("Act 117") amended the Puerto Rico Internal Revenue Code of 1994 (the "PR Code") to provide, among other things, for a general sale and use tax of 5.5% to be imposed by the central government (the "Central Government Sales Tax"). Act 117 also authorized each municipal government to impose a municipal sale and use tax of 1.5% (the "Municipal Sales Tax" and, together with the Central Government Sales Tax, the "Sales Tax"). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods) and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets.

The Sales Tax is imposed on the sale, use, consumption and storage of taxable items, which include tangible personal property, taxable services, admission rights and certain other types of transactions covering separable and identifiable taxable items which are sold for a single price, subject to certain exceptions and limitations. The Sales Tax does not apply to, among other things: (i) taxable items acquired by merchants for resale, (ii) taxable items acquired by manufacturing plants, (iii) taxable items acquired for use and consumption outside of Puerto Rico, (iv) certain food products that do not need to be heated before their sale, (v) prescription drugs, (vi) the rental payments received by a lessor of real property which is used for residential or commercial purposes, (vii) services provided by designated professionals, (viii) cash, cash equivalents, stocks, bonds, notes, mortgage loans, insurance, securities and interest derived for the use or forbearance of money, (ix) sales of real property, and (x) leases in which the Industrial Development Company is the owner of the property.

Act 117 also repealed the 5% general excise tax imposed on imported goods and the 3.6% general excise tax imposed on goods manufactured in Puerto Rico. Other items, such as fuel, crude oil and petroleum products, and vehicles, however, will remain subject to the excise tax previously applicable to such items, and are not subject to the Sales Tax.

The Sales Tax became effective on November 15, 2006 and the effective date of the repeal of the 5% general excise tax was October 16, 2006. Municipalities were authorized to implement the Municipal Sales Tax starting on July 1, 2006, and most have done so. The revenues derived from the Sales Tax are distributed as follows: (i) municipal governments retain 13/15 of the Municipal Sales Tax (equivalent to a tax of 1.5% out of the total 7% Sales Tax), (ii) the Dedicated Sales Tax Fund, created by Act No. 91 of May 13, 2006, as amended, receives one-seventh of the Sales Tax (equivalent to a tax of 1% out of the total 7% Sales Tax), and (iii) the General Fund receives the balance of the Sales Tax (equivalent to a tax of 4.5% out of the total 7% Sales Tax). The Secretary of the Treasury projects for fiscal year 2008 that each percentage point of the Sales Tax generated annually approximately $202 million of gross revenues and that the Sales Tax generated total annual gross revenues for the General Fund of approximately $911 million. For fiscal year 2007, the corresponding projections are $191 million and $576 million. The increase in revenues to be generated by the Sales Tax has been partly offset by the elimination of the 5% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provided for special income tax rates with respect to certain transactions occurring on and between July 1, 2006 and December 31, 2006 (the “Transition Period”). Eligible dividends declared by domestic corporations or partnerships during the Transition Period qualified for a 5% special income tax. The dividend did not need to be distributed to qualify for the 5% special income tax rate. During the Transition Period, Act 117 also provided a special tax rate of 5% (10% in the case of resident corporations and partnerships) in connection with “built-in” gains associated to capital assets held for periods in excess of six months (the “Special Capital Gains Tax”). In order to take advantage of the Special Capital Gains Tax, a taxpayer had to file an election with the Secretary of the Treasury. The sale of the capital asset is not required to qualify for the Special Capital Gains Tax. In addition to the other conditions mentioned herein, the Special Capital Gains Tax was only available in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. However, in the case of resident corporations and partnerships, the Special Capital Gains Tax applied only to real property located in Puerto Rico.

Proposed Sales Tax and Excise Tax Changes

On February 6, 2008, the Governor, in his State of the Commonwealth address, proposed suspending a portion of the current sales and use tax, for a reduction from 7% to 2.5%, and re-instituting a revamped excise tax on goods imported into Puerto Rico to help stimulate the Commonwealth’s economy. The proposal included provisions that would have continued the earmarking of sales tax revenues equal to 1% of the total sales tax rate to the Dedicated Sales Tax Fund and other mechanisms currently in place to ensure the security for the outstanding COFINA bonds. See “Tax Reform” under *Puerto Rico Taxes, Other Revenues and Expenditures,* “Government Development Bank for Puerto Rico – Sales Tax Financing Corporation” under *Public Corporations* and “Public Sector Debt” under *Debt* in the Commonwealth Report in *Appendix I*. On February 7, 2008, the Governor stated that any proposal from his administration would not impair the rights of bondholders and that he would veto any counter-proposal from the Legislature of Puerto Rico that would constitute a possible impairment of the rights of bondholders. On February 7, 2008, Standard & Poor’s Ratings Service (“S&P”) placed the COFINA bonds on CreditWatch Negative and Fitch Ratings Ltd. (“Fitch”) placed the same bonds on Rating Watch. On March 14, 2008, the Governor submitted to the Legislature a proposed bill establishing the conditions for suspending the collection of the 4.5% sales and use tax (which is the portion of the total sales and use tax to be collected for the General Fund), establishing and funding a debt service reserve fund for the benefit of the COFINA bonds and re-instituting the revamped excise tax. Said bill was structured to safeguard the rights of COFINA bondholders and is aimed at preserving the current rating of the COFINA bonds. Such action was expected to be revenue neutral for the General Fund. The legislation proposed by the Governor was not approved by the Legislature.

Major Sources of General Fund Revenues

Income Taxes

The Commonwealth's income tax law, the Internal Revenue Code of 1994, as amended (the "P.R. Code"), imposes a tax on the income of individual residents of Puerto Rico, trusts, estates, and domestic and foreign (if engaged in a trade or business in Puerto Rico) corporations and partnerships at graduated rates. A flat tax is imposed on certain payments made to non-residents of Puerto Rico, which is collected through an income tax withholding.

Individuals. Resident individuals are subject to tax on their taxable income from all sources. The P.R. Code has four tax brackets for individuals with tax rates of 7%, 14%, 25%, and 33%. Dividend income from Puerto Rico corporations and certain qualifying foreign corporations is taxed at a rate of 10%.

Gain realized from the sale or exchange of a capital asset by resident individuals, if held for more than six months, is taxed at a rate of 10%.

Interest income in excess of $2,000 on deposit with Puerto Rico financial institutions is taxed at a rate of 10%; the first $2,000 of interest income from such institutions is exempt from taxation. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations and paid to resident individuals, trusts, estates, corporations and partnerships qualifies for a special 10% tax rate.

Corporations and Partnerships. Puerto Rico corporations and partnerships are subject to tax on income from all sources; foreign corporations and partnerships that are engaged in a trade or business in Puerto Rico are subject to tax on their income from Puerto Rico sources and on income from sources outside Puerto Rico that is effectively connected with the conduct of their trade or business in Puerto Rico. Unless a corporation or partnership qualifies for partial exemption from corporate income and other taxes under the industrial incentives program (see "Tax Incentives" under *The Economy* above), it is subject to tax at graduated rates.

In general, the P.R. Code provides for six income tax brackets for corporations and partnerships, with the highest rate (39%) applicable to net taxable income in excess of $300,000. Also, Act No. 41 of August 1, 2005 was enacted to impose a temporary additional tax of 2.5% on corporations and partnerships with a net taxable income of $20,000 or more. In addition, Act No. 98 of May 16, 2006, provides for an extraordinary tax of 5% on resident corporations and partnerships engaged in business for pecuniary profit and whose gross income for the immediately preceding taxable year ended on or prior to December 31, 2005 exceed $10 million. The 5% tax must be paid on or prior to July 31, 2006 and such amount may be subsequently claimed as a tax credit against such entity's income tax liability. Act No. 89 of May 13, 2006 also imposes an additional special tax for the taxable year commencing in 2006 of 2% on the net income subject to standard taxation of all corporations operating under the provisions of the Puerto Rico Banking Law.

Gains realized from the sale or exchange of a capital asset, if held for more than six months, are taxed at a maximum rate of 15%. Dividends received by Puerto Rico corporations and partnerships of foreign corporations and partnerships engaged in trade or business in Puerto Rico are subject to general income tax rates. A dividends received credit may be available when the corporation or partnership making the distribution is organized in Puerto Rico. A special tax rate of 17% is applicable to dividend distributions of REITs received by corporations. Interest income on certain qualifying debt obligations issued by Puerto Rico corporations and certain qualifying foreign corporations and paid to resident corporations and partnerships qualifies for a special tax rate of 10%.

In general, corporations and partnerships operating under a new grant of tax exemption issued under the 1998 Tax Incentives Act are subject to a maximum income tax rate of 7% during their basic exemption period. Certain corporations and partnerships covered by the tax incentives acts continue to be subject to a maximum tax rate of 45% on their taxable income. Corporations and partnerships covered by the Puerto Rico Tourism Incentives Act of 1993, as amended, are subject to a maximum tax rate of 42% on their taxable income. The P.R. Code also provides for an alternative minimum tax of 22%.

The P.R. Code imposes a branch profits tax on resident foreign corporations less than 80% of whose gross income qualifies as income effectively connected with a Puerto Rico trade or business. The branch profits tax is 10% of an annual dividend equivalent amount, and it applies without regard to the Puerto Rico source of income rules.

Interest from Puerto Rico sources paid to non-resident non-affiliated corporate recipients is not subject to any income or withholding tax. Interest paid to certain related non-resident recipients is subject to a withholding tax of 29%. Dividends paid to non-resident corporate recipients are subject to a withholding tax of 15%. Dividends distributed by corporations (including Section 936 Corporations) operating under new grants of tax exemption issued under the 1998 Tax Incentives Act are not subject to Puerto Rico income tax. However, royalty payments made by such corporations to non-resident recipients are subject to a 15% withholding tax. The basic tax on dividends paid to foreign corporate shareholders of Section 936 Corporations operating under grants of tax exemption issued under prior incentives laws is 10% but is subject to reduction if a percentage of the profits are invested in certain eligible instruments for specified periods of time.

Subject to certain exceptions, payments in excess of $1,500 during a calendar year made by the Commonwealth and persons engaged in a trade or business in Puerto Rico in consideration of the receipt of services rendered in Puerto Rico are subject to a 7% withholding tax.

Sales and Use Taxes

The Sales Tax is imposed on the sale, use, consumption and storage of taxable items, which include tangible personal property, taxable services, admission rights and combined transactions, subject to certain exceptions and limitations. The Sales Tax is not imposed on, among other things: (i) taxable items acquired by merchants for resale, (ii) taxable items acquired by manufacturing plants, (iii) taxable items acquired for use and consumption outside of

Puerto Rico, (iv) certain food products that do not need to be heated before their sale, (v) prescription drugs, (vi) the rental payments received by a lessor of real property which is used for residential or commercial purposes, (vii) services provided by designated professionals, (viii) cash, cash equivalents, stocks, bonds, notes, mortgage loans, insurance, securities and interest derived for the use or forbearance of money, (ix) sales of real property, and (x) leases in which the Industrial Development Company is the owner of the property. The Sales Tax was effective starting on November 15, 2006 and generated approximately $911 million for the General Fund in fiscal year 2008. The Sales Tax is estimated to produce $977 million in fiscal year 2009.

Excise Taxes

The P.R. Code imposed an excise tax on certain articles and commodities, such as cigarettes, alcohol, sugar, cement, motor vehicles and certain petroleum products, which are taxed at different rates. The excise tax imposed on articles and commodities imported into Puerto Rico for consumption in Puerto Rico ended on October 16, 2006 and has been replaced by the previously described sales and use tax on November 15, 2006.

Other Taxes and Revenues

Motor vehicle license plate and registration fees comprise the major portion of license tax receipts.

Non-tax revenues consist principally of lottery proceeds, documentary stamps, permits, fees and forfeits, proceeds of land sales and receipts from public corporations in lieu of taxes.

Revenues from non-Commonwealth sources include customs duties collected in Puerto Rico and excise taxes on shipments of rum from the island to the United States mainland. The customs duties and excise taxes on shipments are imposed and collected by the United States and returned to the Commonwealth. The excise tax on shipments of rum from Puerto Rico and other rum producing countries is $13.50 per gallon. Of this amount, the lesser of $13.25 per proof gallon and the actual excise tax imposed is currently returned to the Treasury.

Property Taxes

Personal property, which accounts for approximately 48% of total collections of taxable property, is self-assessed. Real property taxes are assessed based on 1958 property values. No real property reassessment has been made since 1958, and construction taking place after that year has been assessed on the basis of what the value of the property would have been in 1958. Accordingly, the overall assessed valuation of real property for taxation purposes is substantially lower than the actual market value. Also, an exemption on the first $15,000 of assessed valuation in owner-occupied residences is available.

Property taxes are assessed, determined and collected for the benefit of the municipalities by the Municipal Revenues Collection Center ("CRIM"), a government instrumentality of the Commonwealth. However, a special 1.03% tax on the assessed value of all property (other than exempted property) imposed by the Commonwealth for purposes of paying the Commonwealth's general obligation debt is deposited in the Commonwealth's Redemption Fund.

The following table presents the assessed valuations and real and personal property taxes collected for fiscal years ending June 30, 2003 through June 30, 2008.

Commonwealth of Puerto Rico
Assessed Valuations and Real and Personal Property Taxes
(Commonwealth and Municipalities Combined)
(in thousands)

Fiscal Years Ended June 30,	Assessed Valuations(1)	Taxes Levied	Collections of Current Year	Collections of Previous Years	Total Collections(2)
2003	$23,316,400	$834,974	$671,163	$79,421	$750,584
2004	23,841,557	874,294	706,677	79,772	786,449
2005	25,277,795	899,893	738,074	50,751	788,825
2006	25,606,121	925,618	801,497	70,908	872,405
2007	26,898,519	982,400	813,700	79,720	893,420
2008*	27,960,086	1,024,000			908,000†

(1) Valuation set as of July 1 of each fiscal year.
(2) During fiscal year 2004 a property tax amnesty was approved by the Legislative Assembly and implemented by CRIM. In addition to the amounts shown, under the amnesty program a total of $105.3 million was collected in fiscal year 2004 and $21.1 million in fiscal year 2005.
* Valuations and taxes levied as of December 31, 2007.
† Preliminary

Source: *Municipal Revenues Collection Center*.

Collections of Income, Sales and Excise Taxes

The Treasury has continued its program for improving tax collections. The program consists, in part, of taking the initiative in sponsoring and implementing tax reform, particularly in the areas of excise taxes and income taxes, in order to decrease the incidences of nonpayment of taxes and to expand the taxpayer base. The program has also included (i) improving the methods by which delinquent taxpayers are identified, primarily through the use of computer analyses, (ii) computerizing the processing of tax returns, and (iii) identifying and eliminating taxpayer evasion. With the elimination of the general excise tax last October, Treasury excise tax personnel have been reassigned to monitor compliance with the new sales tax.

Transfers to General Obligation Redemption Fund

These consist of transfers from the General Fund to the Redemption Fund for the amortization of the principal of and interest on general obligation bonds and notes of the Commonwealth.

Components of General Fund Expenditures

Grants and Subsidies

This category includes grants and contributions to municipalities, public corporations with independent treasuries, and charitable institutions. It also includes items for or included in court awards, damage awards for personal injury or property damage, and payment of taxes and payments in lieu of taxes.

Personal Services

This category includes compensation paid for personal services rendered to the Commonwealth and its public instrumentalities by individuals or firms in the form of salaries, wages, *per diems*, fees, commissions, or other forms of compensation.

Other Services

This category includes compensation for services other than the services referred to above, including advertising, printing, communications, legal expenses, utilities, building and equipment rental and maintenance expenses, insurance premiums and miscellaneous services.

Materials and Supplies

This category includes all articles that ordinarily have a short life and durability, lose their characteristic identity in the process of use, have only nominal value ($25 or less), or are not otherwise chargeable as equipment.

Equipment Purchases

This category includes items that have three special characteristics distinguishing them from materials: durability, long useful life, and high unit cost. In addition, these items are subject to centralized inventory control as fixed assets.

Capital Outlays and Other Debt Service

Capital outlays are made primarily for land acquisition or interests in land, construction of buildings, roads, bridges and other structures, and permanent improvements and additions. Other debt service includes payments on notes held by GDB to be paid from the General Fund and payments for the amortization of the principal of and interest on non-general obligations payable from Commonwealth appropriations.

Transfers to Agencies

These transfers include the repayment of loans and advances to other funds, certain refunds, advances from other funds and other receipts, repayment of advances from other funds, grants and contributions to other funds under the custody of the Secretary of the Treasury and other items. The major portion of grants and contributions in recent fiscal years has consisted of transfers to cover the costs of health reform and advances to the municipalities.

Other Expenditures

This category represents recurring General Fund expenditures not appropriately attributable to other expenditure line items, such as advances to government agencies and municipalities, which advances are to be reimbursed to the General Fund by law.

Federal Grants

Puerto Rico receives grants under numerous federal programs. Federal grants to the agencies and instrumentalities of the Commonwealth government, including public corporations, are estimated to be $4.150 billion for fiscal year 2009, a decrease of $65.2 million, or 1.5%, from fiscal year 2008. The following table presents revenues from federal grants by broad program areas, which are accounted in the central accounting system of the Treasury. The figures for fiscal years 2005 through 2007 are actual figures. The figures for fiscal year 2008 are estimates based on the information submitted by each agency to OMB and the figures for fiscal year 2009 are the amounts included in the recommended budget.

The Commonwealth of Puerto Rico
Federal Grants
(in thousands)

	2005	2006	2007	2008(1)	2009(2)
Education	$ 963,032	$1,004,138	$ 986,574	$ 972,708	$ 971,873
Social Services	1,952,405	1,888,150	1,923,845	1,989,398	1,989,692
Health	383,635	432,868	436,892	466,921	479,925
Labor and Human Resources(3)	150,612	197,296	183,228	225,191	231,500
Crime	29,313	41,461	29,631	28,770	26,172
Housing(4)	524,856	371,104	375,581	440,028	343,975
Drug and Justice	6,781	36,979	35,321	16,219	31,609
Agriculture and Natural Resources	9,439	11,402	12,484	9,859	8,083
Contributions to Municipalities	56,371	53,744	48,531	48,531	48,531
Other	14,256	18,251	17,095	17,766	18,852
TOTAL	$4,090,700	$4,055,393	$4,049,182	$4,215,391	$4,150,212

(1) Estimated.
(2) Recommended.
(3) Amounts include grants to the Right to Work Administration and the Occupational Development and Human Resources Council.
(4) Amounts include grants to the Public Housing Administration.

Source: *Office of Management and Budget*

BUDGET OF THE COMMONWEALTH OF PUERTO RICO

Office of Management and Budget

OMB's predominant mission is to assist the Governor in overseeing the preparation of the budget of the Commonwealth and supervise its administration in the agencies of the Executive Branch. In helping to formulate the Governor's budget, OMB evaluates the effectiveness of agency programs, policies, and procedures, assesses competing funding demands among agencies, and sets funding priorities.

In addition, OMB oversees and coordinates the Administration's initiatives in financial management, information technology, general management and organizational structure, and supervises the agencies' compliance with the Governor's program and regulatory policies. In each of these areas, OMB's role is to help improve administrative management, develop better performance measures and coordinating mechanisms, and promote efficiency in the use of public funds.

Budgetary Process

The fiscal year of the Commonwealth begins each July 1. The Governor is constitutionally required to submit to the Legislative Assembly an annual balanced budget of revenues, capital improvements, and operating expenses of the central government for the ensuing fiscal year. The annual budget is prepared by OMB, in coordination with the Planning Board, the Treasury, and other government offices and agencies. Section 7 of Article VI of the Constitution provides that "The appropriations made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."

The annual budget, which is developed utilizing elements of program budgeting, includes an estimate of revenues and other resources for the ensuing fiscal year under (i) laws existing at the time the budget is submitted, and (ii) legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year investment plan prepared by the Planning Board.

The Legislative Assembly may amend the budget submitted by the Governor but may not increase any items so as to cause a deficit without imposing taxes to cover such deficit. Upon passage by the Legislative Assembly, the budget is referred to the Governor, who may decrease or eliminate any item but may not increase or insert any new item in the budget. The Governor may also veto the budget in its entirety and return it to the Legislative Assembly with the Governor's objections. The Legislative Assembly, by a two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the succeeding fiscal year, as was the case for fiscal year 2006, the annual budget for the preceding fiscal year as originally approved by the Legislative Assembly and the Governor is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislative Assembly and the Governor. This permits the Commonwealth to continue making payments of its operating and other expenses until a new budget is approved.

Fiscal Reform

On May 25, 2006, the Governor signed Act No. 103 providing for a fiscal reform of the Commonwealth government (the "Fiscal Reform Legislation"). The Fiscal Reform Legislation applies to every instrumentality and entity of the Executive Branch funded, in whole or in part, from the General Fund and sets forth, as the public policy of the Commonwealth, the reduction of government spending, the elimination or consolidation of redundant agencies, the reduction of government payroll without causing the layoff of regular employees or increasing the actuarial liability of the retirement systems, the limitation of unnecessary, extravagant or excessive spending, and the limitation of public relations and other similar expenses. Despite his approval of the Fiscal Reform Legislation, the Governor has stated that certain of its provisions may be unconstitutional because they infringe on Executive Branch prerogatives. As such, the Governor has informed the Legislative Assembly that certain provisions of the Fiscal Reform Legislation will be implemented at the Executive Branch's discretion and through the use of the Executive Branch's prerogatives. There is no assurance that the Fiscal Reform Legislation will result in the intended reduction of expenditures or that it will be implemented as enacted or that it will not be judicially challenged.

Financial Control and Adjustment Procedures

Revenue estimates for budgetary purposes are prepared by the Treasury, except for estimates of federal grants, which are prepared by OMB based on information received from the various departments and other recipients of such grants. Revenue and federal grant estimates are under continuous review and, if necessary, are revised at least quarterly during the fiscal year. Fiscal control over expenditures is exercised by the Governor, through the Director of OMB, and the Secretary of the Treasury. Monthly reviews and expenditure cut-off procedures are followed to prevent expenditures in excess of appropriations.

During any fiscal year in which the resources available to the Commonwealth are insufficient to cover the appropriations approved for such year, the Governor may take administrative measures to reduce expenses and submit to both houses of the Legislative Assembly a detailed report of any adjustment necessary to balance the budget, or make recommendations to the Legislative Assembly for new taxes or authorize borrowings under provisions of existing legislation or take any other necessary action to meet the estimated deficiency. Any such proposed adjustments shall give effect to the "priority norms" established by law for the disbursement of public funds in the following order of priority; first, the payment of the interest on and amortization requirements for public debt (Commonwealth general obligations and guaranteed debt for which the Commonwealth's guarantee has been exercised); second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain, and other unavoidable obligations to protect the name, credit and good faith of the Commonwealth; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purposes.

A Budgetary Fund was created by Act No. 147 of June 18, 1980, as amended (the "Budgetary Fund"), to cover the appropriations approved in any fiscal year in which the revenues available for such fiscal year are insufficient, to secure the payment of public debt, and to provide for unforeseen circumstances in the provision of public service. Currently, an amount equal to one percent of the General Fund net revenues of the preceding fiscal year is deposited annually into the Fund. In addition, other income (not classified as revenues) that is not assigned by law to a specific purpose is also required to be deposited in the Budgetary Fund. The maximum balance of the Budgetary Fund may not exceed 6% of the total appropriations included in the budget for the preceding fiscal year. As of March 31, 2008, the Budgetary Fund balance was $0.

An Emergency Fund was created by Act No. 91 of June 21, 1966, as amended (the "Emergency Fund"), to cover unexpected public needs caused by calamities, such as wars, hurricanes, earthquakes, droughts, floods and plagues, and to protect people's lives and property and the public sector credit. The Emergency Fund is capitalized annually with an amount totaling no less than one percent of the General Fund net revenues of the preceding fiscal year.

Act No. 91 was amended in 2003 to set an upper limit to the Emergency Fund of $150 million at the beginning of the fiscal year and was further amended in 2005 to authorize the disbursement of funds from the Emergency Fund to cover certain General Fund expenditures and operational costs of the State Emergency Management Agency. The 2005 amendment also authorizes GDB to lend to the Commonwealth up to $150 million to replenish the Emergency Fund to provide funding for emergency and disaster needs. As of March 31, 2008, the balance in the Emergency Fund was less than $1 million.

Appropriations

Appropriations in the central government budget of Puerto Rico consist of the following:

(i) General Fund appropriations for recurring ordinary operating expenses of the central government and of the Legislative Assembly are made by a single annual law known as the Joint Resolution of the General Budget.

(ii) General Fund appropriations for special operating expenses, for contributions to municipalities, the University of Puerto Rico and the Judiciary Branch and for capital expenditures are authorized by separate law for one or more years for special programs or activities, which may be permanent or transitory.

(iii) Disbursements of Special Funds for operating purposes and for capital improvements. For the most part, such disbursements do not require annual legislative authorization, because they are authorized by previous legislation or by the United States Congress. Federal grants constitute the major part of the resources of the Special Funds.

(iv) Bond Fund appropriations for capital expenditures financed by bonds. Such expenditures occur in one or more years.

In Puerto Rico, the central government performs many functions, which in the fifty states are the responsibility of local governments, such as providing public education, police and fire protection. The central government also provides significant annual grants to the University of Puerto Rico and to the municipalities.

For fiscal year 2007, approximately 47% of the General Fund was committed for payment of the central government payroll. In addition, approximately 26% of the General Fund was committed to the payment of fixed charges such as municipal subsidies, grants to the University of Puerto Rico, funding for the judicial branch, among others, and debt service on the direct debt of the Commonwealth. For fiscal year 2008, it is estimated that approximately 47% and 6% of the General Fund was committed for payment of the central government payroll (not including the University of Puerto Rico and judicial branch) and debt service on the direct debt of the Commonwealth, respectively. Commencing with fiscal year 2004, the Commonwealth appropriates annually to the judicial branch an amount initially equal to 3.3% of the average annual revenue from internal sources for each of the two preceding fiscal years. This percentage will increase until it reaches 4% in fiscal year 2008, and may be further increased upon review, with scheduled reviews every five years.

Budget for Fiscal Year 2008

The consolidated budget for fiscal year 2008 totaled $27.1 billion. Of this amount, $14.5 billion was assigned to the central government. This includes General Fund total appropriations of $9.227 billion, which represented an increase of $3 million over expenditures for fiscal year 2007. The following table presents a summary of the Commonwealth's central government budget appropriations for the fiscal year ending June 30, 2008.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2008
(in thousands)*

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ 0	$ -	$ 120,726	$ 120,726
Personal income taxes	2,793,198	-	-	2,793,198
Retained non-resident income tax	1,087,782	-	-	1,087,782
Corporate income taxes	1,565,458	-	-	1,565,458
Partnership income taxes	1,942	-	-	1,942
Tollgate taxes	21,610	-	-	21,610
17% withholding tax on interest	13,657	-	-	13,657
10% withholding tax on dividends	59,770	-	-	59,770
Inheritance and gift taxes	6,600	-	-	6,600
Sales and use taxes	911,000		-	911,000
Excise taxes:				
Alcoholic beverages	268,095	-	-	268,095
Motor vehicles and accessories	366,343	-	-	366,343
Cigarettes	119,124	-	-	119,124
Other (excise taxes)	110,017	-	24,400	134,417
Licenses	87,631	-	-	87,631
Miscellaneous non-tax revenues:				
Contributions from lottery fund	46,636	-	-	46,636
Electronic lottery	105,346	-	-	105,346
Registration and document certification fees	168,943	-	-	168,943
Other	152,954	-	346,469	499,423
Total revenues from internal sources	7,886,106	-	491,595	8,377,701
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	361,827	-	-	361,827
Federal grants	-	-	4,215,391	4,215,391
Customs	4,796	-	-	4,796
Total revenues from non-Commonwealth sources	366,623	-	4,215,391	4,582,014
Total revenues	8,252,729	-	4,706,986	12,959,715
Other:				
Other Income	150,000	-		150,000
Balance from previous year	-	-	744,251	744,251
Bonds authorized	-	250,000	-	250,000
Total other sources	150,000	250,000	744,251	1,144,251
Total resources	8,821,000	250,000	5,451,237	14,103,966
Appropriations:				
Current expenses:				
General government	825,110	-	59,936	885,046
Education	3,340,777	-	1,209,947	4,550,724
Health	1,480,448	-	505,587	1,986,035
Welfare	365,106	-	2,335,248	2,700,354
Economic development	187,454	-	97,182	284,636
Public safety and protection	1,692,489	-	72,984	1,765,473
Transportation and communication	86,440	-	70,801	157,241
Housing	26,139	-	268,267	294,406
Contributions to municipalities	360,779	-	1,781	362,560
Special pension contributions	296,132	-	-	296,132
Debt service	450,702	-	120,726	571,428
Other debt service (appropriations)	103,424	-	56,348	159,772
Total appropriations – current expenses	9,215,000	-	4,798,807	14,013,807
Capital improvements	12,000	250,000	182,419	444,419
Total appropriations	9,227,000	250,000	4,981,226	14,458,226
Year-end balance	(824,271)	-	470,011	(354,260)
Total appropriations and year-end balance	$ 8,402,729	250,000	$ 5,451,237	$14,103,966

* Totals may not add due to rounding.
(1) Does not include grants received by agencies whose accounting systems are not centralized in the Treasury.
(2) Act No. 93 of August 20, 1997 establishes that resources that do not represent revenues become part of the Budgetary Fund.

Sources: Department of the Treasury and Office of Management and Budget

Estimated expenses and capital improvements of all budgetary funds totaled $14.5 billion, an increase of $207.3 million from fiscal year 2007. The major changes in General Fund expenditures by program in fiscal year 2008 were mainly due to increases in health (up $99.1 million), public safety and protection (up $76.2 million), special pension contributions (up $30.1 million), transportation and communication (up $9.4 million), other debt service (up $8.9 million), housing (up $1.6 million) and decreases in welfare (down $100.8 million), debt service on Commonwealth's general obligation and guaranteed debt (down $49.2 million), contributions to municipalities (down $26.9 million), economic development (down $21.3 million), education (down $20.8 million) and general government (down $2 million).

Budget for Fiscal Year 2009

The consolidated budget for fiscal year 2009 totals $26.3 billion. Of this amount, $14.5 billion is assigned to the central government. This includes General Fund total resources and appropriations of $9.484 billion, which represents an increase of $256.8 million over approved expenditures for fiscal year 2008. The fiscal year 2009 budget marks the third consecutive year in which budgeted expenditures are below the fiscal year 2006 level. The increase in expenditures is mainly due to University of Puerto Rico, judiciary and municipal formula increases and salary increases mandated by law or collective bargaining agreements. An additional $42.3 million is budgeted for the State Election Commission. The General Fund revenue projection for fiscal year 2009 is $8.488 billion, an increase of $235.3 million, or 2.8%, from estimated net revenues for fiscal year 2008 of $8.253 billion. The Commonwealth's budgeted expenditures for fiscal year 2009 of $9.484 billion exceed projected revenues of $8.488 by approximately $1 billion. The Commonwealth's economic team is working together to enforce spending control measures that have been established to attempt to minimize the budget risk. The following table presents a summary of the Commonwealth's central government budget appropriations for the fiscal year ending June 30, 2009.

Commonwealth of Puerto Rico
Summary of Central Government Annual Budget
Fiscal Year Ending June 30, 2009
(in thousands)*

	General Fund	Bond Fund	Special Funds	Total
Revenues from internal sources:				
Property taxes	$ -	$ -	$ 121,330	$ 121,330
Personal income taxes	2,770,000	-	-	2,770,000
Retained non-resident income tax	1,015,000	-	-	1,015,000
Corporate income taxes	1,751,000	-	-	1,751,000
Partnership income taxes	3,000	-	-	3,000
Tollgate taxes	10,000	-	-	10,000
17% withholding tax on interest	12,000	-	-	12,000
10% withholding tax on dividends	67,000	-	-	67,000
Inheritance and gift taxes	5,000	-	-	5,000
Sales and use taxes	977,000			977,000
Excise taxes:				
Alcoholic beverages	292,000	-	-	292,000
Motor vehicles and accessories	414,000	-	-	414,000
Cigarettes	121,000	-	-	121,000
Other (excise taxes)	95,000	-	21,701	116,701
Licenses	96,000	-	-	96,000
Miscellaneous non-tax revenues:				
Contributions from lottery fund	59,000	-	-	59,000
Electronic lottery	89,000	-	-	89,000
Registration and document certification fees	195,000	-	-	195,000
Other	140,000	-	358,747	498,747
Total revenues from internal sources	8,111,000	-	501,778	8,612,778
Revenues from non-Commonwealth sources:				
Federal excise taxes on off-shore shipments	372,000	-	-	372,000
Federal grants	-	-	4,150,212	4,150,212
Customs	5,000	-	-	5,000
Total revenues from non-Commonwealth sources	377,000	-	4,150,212	4,527,212
Total revenues	8,488,000	-	4,651,990	13,139,990
Other:				
Other Income	1,000,000	-		1,000,000
Balance from previous year	-	-	470,011	470,011
Bonds authorized	-	-	-	-
Total other sources	1,000,000	-	470,011	1,470,011
Total resources	9,488,000	-	5,122,001	14,610,001
Appropriations:				
Current expenses:				
General government	896,345	-	59,554	955,899
Education	3,434,366	-	1,372,284	4,806,650
Health	1,558,940	-	501,945	2,060,885
Welfare	495,172	-	2,345,347	2,840,519
Economic development	180,454	-	94,356	274,810
Public safety and protection	1,696,771	-	69,105	1,765,876
Transportation and communication	97,515	-	75,670	173,185
Housing	29,240	-	274,863	304,103
Contributions to municipalities	378,342	-	1,781	380,123
Special pension contributions	313,641	-	-	313,641
Debt service	288,000	-	121,330	409,330
Other debt service (appropriations)	115,006	-	56,644	171,650
Total appropriations – current expenses	9,483,792	-	4,972,879	14,456,671
Capital improvements	-	-	92,635	92,635
Total appropriations	9,483,792	-	5,065,514	14,549,306
Year-end balance	4,208	-	56,487	60,695
Total appropriations and year-end balance	$ 9,488,000	-	$ 5,122,001	$14,610,001

* Totals may not add due to rounding.
(1) Does not include grants received by agencies whose accounting systems are not centralized in the Treasury.
(2) Act No. 93 of August 20, 1997 establishes that resources that do not represent revenues become part of the Budgetary Fund.

Sources: Department of the Treasury and Office of Management and Budget

Projected expenses and capital improvements of all budgetary funds total $14.5 billion, an increase of $91.1 million from fiscal year 2008. The major changes in General Fund expenditures by program in fiscal year 2009 are mainly due to increases in welfare (up $130.1 million), education (up $93.6 million), health (up $78.5 million), general government (up $71.2 million), special pension contribution (up $17.5 million), contributions to municipalities (up $17.6 million), public safety and protection (up $4.3 million), other debt service (up $11.6 million), transportation and communication (up $11.1 million), housing (up $3.1 million) and decreases in debt service on Commonwealth's general obligation and guaranteed debt (down $162.7 million) and economic development (down $7.0 million).

Differences between Budget and Basic Financial Statements

Revenues and expenditures, as reported by the Treasury in its Basic Financial Statements, may differ substantially from resources and appropriations in the annual budget for a number of reasons, including the following:

(i) The budgetary accounts are on a cash basis, while financial statements prepared by the Treasury include accruals and other adjustments as required by government accounting standards.

(ii) Expenditures for current purposes in a particular fiscal year may include amounts appropriated for earlier periods but not previously expended and, conversely, may exclude amounts appropriated for such fiscal year but not expended until later periods.

(iii) Bonds are authorized by the Commonwealth in accordance with a four-year capital improvement program. Since bond sales are determined by bond market conditions and other factors, the amounts of bonds sold for these improvements are financed by advances from the General Fund to the Capital Projects Fund, which are later reimbursed from proceeds of bond or notes sales.

LITIGATION

The Commonwealth is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended ("Act No. 104"), persons are authorized to sue the Commonwealth only for causes of actions specified in said Act. The Commonwealth may be liable under Act No. 104 for damages up to a maximum amount of $75,000 or $150,000 if the suit involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended ("Act No. 9"), the Commonwealth may provide its officers and employees, including directors of public corporations and government instrumentalities and mayors of the municipalities of the Commonwealth, with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the amount of the judgment that may be paid under Act No. 9.

With respect to pending and threatened litigation, as of June 30, 2007, the Commonwealth has included in its financial statements reported liabilities of approximately $950 million for awarded and anticipated unfavorable judgments. While amounts claimed exceed $6 billion, such amount represents the amount estimated at the time as a probable liability or a liability with a fixed or expected due date, which would require future available financial resources for its payment. The Commonwealth believes that the ultimate liability in excess of amounts provided in the financial statements, if any, would not be significant.

The Commonwealth is a defendant in two lawsuits filed, one in Commonwealth court and one in the United States District Court for the District of Puerto Rico, by an association of primary care health centers seeking to recover from the Commonwealth $800 million of Medicaid funds retained by the Department of Health since 1997. In June 2004, the Superior Court of the Commonwealth in San Juan determined that the Commonwealth must return those funds. The Supreme Court of Puerto Rico, however, upheld a partial ruling allowing the Commonwealth to deduct from the payments due to the centers certain of the payments received by the centers from the federal government. Currently, audits are being carried out on the plaintiff centers. As of June 30, 2007, the Commonwealth has accrued $50 million for this legal contingency. With respect to the federal case, a preliminary injunction was issued by the court against the Commonwealth requiring it to disburse approximately $20 million in six payments beginning in October 2005.

The Commonwealth is also a defendant in a class action presented by parents of special education students alleging deficient services to these students in the areas of education and health care before Commonwealth Courts. One court recently decided in favor of the parents' request to include damage claims in the same class action case. This court may now award damages to the class action members, and in doing so may consider the claims in groups or each case individually. This will require that the parents prove the damages suffered. The Commonwealth plans to defend vigorously each case. As of June 30, 2007, the Commonwealth had accrued $450 million for this legal contingency.

This decision is appealable and thus, not final at this time. The Commonwealth does not anticipate any final determination or damages award, in any case, to be granted in this fiscal year.

The Commonwealth and various component units are defendants in other lawsuits alleging violations of civil rights, breach of contract, and other damage claims. Preliminary hearings and discovery proceedings are in progress. The amounts claimed exceed $5 billion; however, the ultimate liability cannot be presently determined. It is the opinion of the Commonwealth that the claims are excessive. No provision for any liability that may result upon adjudication of these lawsuits has been recognized by the Commonwealth. The Commonwealth believes that the ultimate liability, if any, would not be significant.

APPENDIX II

COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE COMMONWEALTH FOR THE FISCAL YEAR ENDED JUNE 30, 2007

[THIS PAGE INTENTIONALLY LEFT BLANK]

COMMONWEALTH OF PUERTO RICO

Comprehensive Annual Financial Report

Year ended June 30, 2007

COMMONWEALTH OF PUERTO RICO

Comprehensive Annual Financial Report

Year ended June 30, 2007

Table of Contents

COMMONWEALTH OF PUERTO RICO

Comprehensive Annual Financial Report

Year ended June 30, 2007

Statistical Section (Unaudited)

INTRODUCTORY SECTION

TREASURY · COMMONWEALTH OF PUERTO RICO

June 15, 2008

The Honorable Governor of Puerto Rico
Members of the Legislature, and People of Puerto Rico:

It is a pleasure to submit, for your information, the Comprehensive Annual Financial Report (CAFR) of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the fiscal year ended June 30, 2007. This report, presented in three sections, Introductory, Financial, and Statistical, is the primary means of reporting the Commonwealth's financial activities.

The introductory section, which is not audited, includes this letter of transmittal, general information about the Commonwealth, a list of the Commonwealth's principal elected and appointed officials at the balance sheet date, and an organizational chart. The financial section contains the independent auditors' report, management's discussion and analysis (MD&A), and the basic financial statements as listed in the table of contents. The financial section also includes the notes to the basic financial statements, required supplementary information, and other supplementary information. The statistical section, which is not audited, includes selected financial and demographic information, generally presented on a multiyear basis.

Profile of the Commonwealth

The Puerto Rico Department of the Treasury is responsible for the preparation of this report. The responsibility for the accuracy of presented data and the completeness and fairness of the presentation, including all of the disclosures, rests on the Commonwealth's management. To the best of our knowledge and belief, the following data, as presented, is accurate in all material respects and is presented in a manner designed to set forth the financial position and the results of operations of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth as of June 30, 2007 and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America. We have included all the necessary disclosures to enable the reader to gain a thorough understanding of the Commonwealth's activities.

The financial reporting entity includes all funds of the Commonwealth, which comprises the primary government, as well as all its component units. In accordance with Governmental Accounting Standards Board's Statement No. 14, the Commonwealth's financial reporting entity includes 50 component units: 6 are blended component units including 3 fiduciary component units, 8 major discretely presented component units, and 36 nonmajor discretely presented component units. Component units are legally separate entities for which the primary government is financially accountable, or other organizations; the nature and significance of whose relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading and incomplete. Blended component units, although legally separate entities, are, in substance, part of the primary government's operations and are included as part of the primary government. Discretely presented component units, both major and nonmajor, are reported in a separate column in the government-wide financial statements to emphasize that they are not part of the primary government and to differentiate their financial position and results of operations from those of the primary government.

Generally, each component unit issues audited financial statements, which can be obtained from the component unit's administrative offices. The basic financial statements included in the financial section of this CAFR provide descriptions of the operations of each of the following component units of the Commonwealth:

Blended Component Units:

Public Buildings Authority
Puerto Rico Maritime Shipping Authority
The Children's Trust

Discretely Presented Component Units:

Agricultural Services and Development Administration
Automobile Accident Compensation Administration
Cardiovascular Center Corporation of Puerto Rico and the Caribbean
Caribbean Basin Projects Financing Authority
Culebra Conservation and Development Authority
Economic Development Bank for Puerto Rico
Employment and Training Enterprises Corporation
Farm Insurance Corporation of Puerto Rico
Fine Arts Center Corporation
Governing Board of the 9-1-1 Service
Government Development Bank for Puerto Rico
Institute of Puerto Rican Culture
Institutional Trust of the National Guard of Puerto Rico
Land Authority of Puerto Rico
Musical Arts Corporation
National Parks Company of Puerto Rico
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives
Puerto Rico Aqueduct and Sewer Authority
Puerto Rico Conservatory of Music Corporation
Puerto Rico Convention Center District Authority
Puerto Rico Council on Higher Education
Puerto Rico Electric Power Authority
Puerto Rico Government Investment Trust Fund
Puerto Rico Health Insurance Administration
Puerto Rico Highways and Transportation Authority
Puerto Rico Industrial Development Company
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority
Puerto Rico Infrastructure Financing Authority
Puerto Rico Land Administration
Puerto Rico Medical Services Administration
Puerto Rico Metropolitan Bus Authority
Puerto Rico Municipal Finance Agency
Puerto Rico Ports Authority

Puerto Rico Public Broadcasting Corporation
Puerto Rico Sales Tax Financing Corporation
Puerto Rico School of Plastic Arts
Puerto Rico Solid Waste Authority
Puerto Rico Telephone Authority
Puerto Rico Tourism Company
Puerto Rico Trade and Export Company
Right to Employment Administration
Special Communities Perpetual Trust
State Insurance Fund Corporation
University of Puerto Rico

Fiduciary Component Units:

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities
Puerto Rico Judiciary Retirement System
Puerto Rico System of Annuities and Pensions for Teachers

Independent Auditors

Commonwealth statutes require an annual audit by independent certified public accountants. The firm of KPMG LLP was selected by the Commonwealth to perform the audit of the basic financial statements in accordance with auditing standards generally accepted in the United States of America for the fiscal year 2006 – 2007. The goal of the independent audit was to provide reasonable assurance that the financial statements of the Commonwealth for the fiscal year ended June 30, 2007 are fairly stated in accordance with U.S. generally accepted accounting principles. The independent auditors' report on the basic financial statements is included in the financial section of this report.

Internal Controls

The management of the Commonwealth is responsible for establishing and maintaining internal controls to ensure that assets of the Commonwealth are protected from loss, theft, or misuse, and that adequate accounting data is compiled for the preparation of financial statements in conformity with U.S. generally accepted accounting principles. The internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

As a recipient of federal assistance, the Commonwealth is also responsible for ensuring that internal controls are in place to ensure that documents and processes are in compliance with applicable laws and regulations related to such federal financial assistance programs.

Certain departments, agencies, and political subdivisions are subject to the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133. As a result, these entities are audited for compliance with the requirements of the federal financial assistance programs. These audits are performed at the department or agency level. The Commonwealth has provided for the possible cost disallowance that may arise from these audits, as well as from other audits that may be performed by federal grantors.

HACIENDA ESTADO LIBRE ASOCIADO DE PUERTO RICO

SECRETARIO DE HACIENDA

Budget and Fiscal Policy

The fiscal year of the Commonwealth begins each July 1. The Governor is constitutionally required to submit to the Legislature an annual balanced budget of capital improvements and operating expenses of the central government for the ensuing fiscal year.

The annual budget is prepared by the Puerto Rico Office of Management and Budget, working with the Puerto Rico Planning Board, the Puerto Rico Department of the Treasury, and other government offices and agencies. Section 7 of Article 6 of the Constitution provides that "*The appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for the said fiscal year unless the imposition of taxes sufficient to cover the said appropriations is provided by law.*"

The Commonwealth's budgeted expenditures for fiscal year 2007 of $9,488 billion exceeded projected revenues of $9,163 billion by approximately $325 million. The Commonwealth expected to cover this budget deficit through the implementation of additional expenditure reducing measures, a possible increase in tax revenues resulting from the reduction of the uncertainty surrounding the government's fiscal crisis, and cash management mechanisms. The possible increase in tax revenues was tempered by the adverse economic impact resulting from increases in the price of oil and the implementation of the sales and use tax.

The Commonwealth maintains extensive budgetary controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Legislature. Activities of the general fund are included in the annual appropriated budget. Budgetary control resides at the department level. The Commonwealth also maintains an encumbrance accounting system as one method of maintaining budgetary control.

The annual budget, which is developed using elements of program budgeting, includes an estimate of revenue and other resources for the ensuing fiscal year under laws existing at the time the budget is submitted and legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year investment plan prepared by the Puerto Rico Planning Board.

The Legislature may amend the budget submitted by the Governor, but may not increase items that would cause a deficit without imposing additional taxes to cover such deficit. Once approved by the Legislature, the budget is referred to the Governor, who may decrease or eliminate any item, but may not increase or insert new items in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by a two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, as originally approved by the Legislature and the Governor, it is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This allows the Commonwealth to continue to pay operating and other expenses until a new budget is approved.

Governmental Activities

General governmental activities of the Commonwealth are accounted for in four governmental funds. These funds are: general, special revenue, debt service, and capital project. The general fund is the primary operating fund of the Commonwealth. The general fund is used to account for resources traditionally associated with government, which are not required legally or by sound financial management to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, education, and economic development. Other major funds are the debt service fund, which accounts for the accumulation of resources predominantly for, and the payment of, the Commonwealth general long-term bonds' principal, interest, and related costs; the Public Buildings Authority capital projects fund, which accounts for the financial resources used for the acquisition and construction of major capital facilities; and The Children's Trust special revenue fund, which accounts for the moneys received by the Commonwealth from a global settlement agreement dated November 23, 1998 between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The financial resources received by this fund are used to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico. Nonmajor governmental funds are combined in a single column in the governmental fund financial statements, and individually identified in the supplementary combining nonmajor governmental funds' financial statements of this report.

Business-Type Activities

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the government is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where the government has decided that periodic determination of net income is appropriate for accountability purposes.

The Commonwealth's proprietary operations comprise the following activities: the Unemployment Insurance Trust Fund and the Lottery of Puerto Rico and the Additional Lottery System (the Lotteries Fund) and both major funds. The Puerto Rico Water Pollution Control Revolving Fund, the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, the Disability Insurance Fund, and the Drivers' Insurance Fund are all nonmajor proprietary funds combined in a single column in the proprietary fund financial statements, and individually identified in the supplementary combining nonmajor proprietary funds' financial statements of this report.

Fiduciary Operations

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity or as an agent for individuals, private organizations, and other governmental units. These include the pension trust and agency funds. Pension trust funds are established through trust agreements specifying how the fund will operate. Agency funds are custodial in nature and do not report fund balances. The pension trust funds include the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities, the Puerto Rico Judiciary Retirement System, and the Puerto Rico System of Annuities and Pensions for Teachers.

AN

Agency funds consist of the Special Deposits Fund. This agency fund includes deposits under the custody of the Courts of Justice for alimony payments, deposits under the custody of the Commissioner of Insurance of the Commonwealth for escheated property, and for insurance companies under bankruptcy.

HACIENDA ESTADO LIBRE ASOCIADO DE PUERTO RICO

SECRETARIO DE HACIENDA

Cash Management Policies and Practices

The Commonwealth maintains a cash pool for its cash and cash equivalents. The balance in the pooled cash accounts is available to meet current operating requirements and any excess is invested in various interest-bearing accounts in the Government Development Bank for Puerto Rico (GDB), a discretely presented component unit. In addition, the Puerto Rico Government Investment Trust Fund (PRGITF) was created by the Commonwealth pursuant to Act No. 176 of August 11, 1995, and began operations on December 4, 1995. PRGITF is a no-load diversified collective investment trust that was created for the purpose of providing eligible investors with a convenient and economical way to invest in a professionally managed money market portfolio. The deposits on hand and the investments purchased are not collateralized, secured, or guaranteed by the Commonwealth or any of its agencies, instrumentalities, or political subdivisions.

The Commonwealth's investment policy is to minimize credit and market risk while maintaining a competitive yield on its portfolio. The cash temporarily idle during this year was invested mainly in U.S. government securities, stocks, corporate bonds, repurchase agreements, Commonwealth securities other trading securities, and short-term investments. These are primary government investments that are restricted and unrestricted.

Capital Assets

These basic financial statements include the capital assets of the Commonwealth. A discussion of capital assets accounting is included in the MD&A that is part of the basic financial statements. More detailed information about capital assets can be found in the notes to the basic financial statements.

Debt Administration

As of June 30, 2007, the Commonwealth had a number of debt issues outstanding. The Commonwealth has a BBB- credit rating from Standard & Poor's Rating Services and a Baa3 from Moody's Investor Service on general obligation bond issues; these classifications may vary in future years. Section 2 of Article VI of the Constitution of Puerto Rico provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit and taxing power of the Commonwealth shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes issued thereafter, which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenue raised under the provisions of the Commonwealth Legislation and covered into the Treasury of Puerto Rico in the two fiscal years preceding the current fiscal year. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. See the computation of the legal debt margin on page 6 in the statistical section. More detailed information about long-term debt can be found in the notes to the basic financial statements.

Risk Financing

The Commonwealth purchases commercial insurance to cover casualty, theft, tort claims, and other losses. The current insurance policies have not been canceled or terminated. As it relates to workers' compensation, the Commonwealth's discretely presented component unit, the State Insurance Fund Corporation, provides workers' compensation to both public and private employees.

Financial Advisor and Fiscal Agent

The principal functions of GDB are to act as financial advisor to and fiscal agent for the Commonwealth, its municipalities, and public corporations, in connection with the issuance of bonds and notes, and to make loans to private enterprises to aid the economic development of Puerto Rico.

Economic Conditions and Outlook

The economy of Puerto Rico is closely linked to the U.S. economy. The following exogenous variables are affected by the U.S. economy: exports, direct investment, transfer payments, interest rates, inflation, and tourist expenditures.

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. Manufacturing is the largest sector in terms of gross domestic product. Manufacturing in Puerto Rico is now more diversified than during the earlier phases of its industrial development and includes several industries less prone to business cycles. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor.

The services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism, and other services, has shown a strong interaction with manufacturing, tourism, construction, and agriculture.

Tourism makes a significant contribution to economic activity. An estimated $3.4 billion were spent by visitors in Puerto Rico during fiscal year 2007. San Juan has become the largest home port for cruise ships in the Caribbean and the fourth largest home port for cruise ships in the world. During the fiscal year 2007, the number of visitors increased 0.8% compared with fiscal year 2006. The construction sector is an integral part of the economic activity from fiscal year 1999 through fiscal year 2007. Puerto Rico is heavily dependent on oil imports for the production of electricity; however, as a result of the construction of two cogeneration plants, one of which is fueled by liquefied natural gas and the other by coal, Puerto Rico's dependence on oil imports for the production of electricity has been reduced from 99.0% to 74.0%. Currently, as part of the Puerto Rico Electric Power Authority's capital improvement plan, the Puerto Rico Electric Power Authority is considering building an additional cogeneration power plant fueled by liquefied natural gas in the municipality of Mayagüez.

The Puerto Rico Planning Board's preliminary reports of the performance of the Puerto Rico economy during fiscal year 2007 indicate that the economy registered a decrease of 1.8% in total real gross product. Gross product in fiscal year 2000 was $41.4 billion and gross product in fiscal year 2007 was $58.7 billion. This represents an increase in gross product of 42.0% from fiscal year 2000 to fiscal year 2007.

In terms of personal income, in fiscal year 2007, personal income per capita was $13,491 compared to $13,033 in 2006 and $10,204 in 2000.

A7

According to the Puerto Rico Department of Labor and Human Resources, during fiscal year 2007, the labor force was 1.41 million compared to 1.42 million in fiscal year 2006. The average unemployment rate decreased from 11.7% during fiscal year 2006 to 10.4% in fiscal year 2007.

HACIENDA
ESTADO LIBRE ASOCIADO DE PUERTO RICO

SECRETARIO DE HACIENDA

Major Initiatives

Tax Regime for Companies Doing Business in Puerto Rico

In order to enhance the desirability for U.S. companies to establish operations in Puerto Rico, after the elimination of Section 936 of the U.S. Internal Revenue Code (IRC), the Commonwealth has tried different efforts to improve its tax treatment to foreign companies. It pursued an amendment to Section 956 of the IRC during 2001 to 2003, and it introduced several changes to the tax incentive law of 1997. Also, during May 2008, the Commonwealth approved a new tax incentive law. All these efforts are expected to advance the manufacturing sector, which has a great impact on the rest of the economic activity.

Public Sector Debt

Historically, the Commonwealth has maintained, as a matter of fiscal policy, a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. During certain fiscal years, however, public sector debt increased at a greater rate than the rate of gross product primarily due to an increase in the amount of debt incurred to finance certain key infrastructure projects, which are important to the development of the economy and are expected to produce long-term economic benefits, and debt incurred to refinance outstanding debt to enable Puerto Rico to benefit from the historically low levels of interest rates and realize debt service savings. During fiscal year 2007, public sector debt increased 7.22%.

Prospects for the Future

The Commonwealth is committed to research and pursue solutions to improve the Commonwealth's competitive economic performance and the quality of life for its people. The Commonwealth's economic development program is focused on initiatives aimed at producing more diversified and sustainable economic development. The six principal elements of these initiatives, as expressed in the Governor's Economic Development and Government Transformation Plan for Puerto Rico, are the following: (i) developing world-class infrastructure, while encouraging private investment with innovative financial models and agile, effective evaluation processes; (ii) accelerating Puerto Rico's entry into the knowledge economy by creating a center of excellence in biotechnology, engineering and computing; (iii) promoting local enterprise and supporting local businesses (in Spanish, Apoyo al de Aquí) by providing innovative financing alternatives and access to domestic and foreign markets; (iv) transforming the tourist industry into a vehicle for Puerto Rico's economic development; (v) diversifying energy-generating sources to reduce dependence on petroleum by half; and (vi) transforming Puerto Rico's government, without the need for layoffs or privatization, through effective agency consolidation and decentralization functions to offer first-class services to all citizens in a sensible, effective and agile manner and to contribute to Puerto Rico's socio-economic development. subsidies provided to governmental entities; and (5) refocused strategic projects related to the citizen's health.

The tax reform which is in force since November 15, 2006 replaced the Commonwealth's general excise tax (5%) with the sales and use tax. This new tax regime included compensatory income tax credits in order to address any regressive effect that the consumption tax may have and eliminated the marriage penalty, beginning with the tax year 2008. The Puerto Rico Department of the Treasury expects that the tax reform will provide a net increase in the general fund's annual revenues, after taking into consideration projected reductions in income taxes, in an amount sufficient to reduce and eventually eliminate the structural budget imbalance.

The proposed fiscal reform includes a long-term plan to reduce and improve the management of the Commonwealth's public debt. Upon the elimination of the structural budget imbalance, which elimination must be certified to the Legislative Assembly and the Governor by the Secretary of the Treasury, the Director of OMB, and the President of GDB, the Commonwealth's operating budget will include an annual contribution to the public improvement fund equal to 2% of the total amount of the public improvement bonds authorized for that fiscal year. The annual contribution to the public improvement fund will increase by an additional 2% of the then-current authorization for each fiscal year thereafter, up to a maximum of 20% of the current year's authorized public improvement bond issuance. This contribution is intended to reduce proportionally each year the amount of the Commonwealth's public improvement bond issues.

The Commonwealth faces other fiscal challenges besides its current budgetary issues. The principal one involves resolving the increasing unfunded pension liability of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (Employees' Retirement System) and the Puerto Rico System of Annuities and Pensions for Teachers (the Teachers Retirement System). The Commonwealth expects to reduce the unfunded liability of the Employees' Retirement System based on proposed legislation, which provides for increased employer and employee contributions and the issuance of up to $2 billion of pension obligation bonds, which would be payable from the Commonwealth's general fund. Besides, the Employees' Retirement System is considering an issue of bonds to improve unfunded pension liability of the fund. The Employees' Retirement System and the Teachers Retirement System are also seeking reimbursement from the Commonwealth for certain special retirement benefits paid by them in prior fiscal years under legislation providing such retirement benefits.

Financial Condition

The MD&A, which can be found immediately following the independent auditors' report, provides an overview of the Commonwealth's financial activities addressing both governmental and business-type activities reported in the governmentwide financial statements. In addition, the MD&A focuses on the Commonwealth's major funds. Component units and fiduciary activities are excluded from the MD&A.

Estimated Fiscal Year 2008 Compared to Actual Fiscal Year 2007

As revised, estimated general fund total revenue for fiscal year 2008 is $8.821 billion, representing a decrease of $41.5 million from fiscal year 2007 revenue. The 2007 revenue projections and subsequent revision take into account (i) the Puerto Rico Planning Board's downward revision of its forecast for real growth in gross national product from 0.6% to 1.8%, (ii) the substitution of the sales and use tax for the 5.0% general excise tax, and (iii) certain income tax rate reductions included in the tax reform legislation of 2006.

Other Information

Acknowledgements

The preparation of this report requires the collective efforts of numerous finance personnel throughout the Commonwealth and is made possible only with the cooperation and support of the Executive, Legislative, and Judicial branch agencies, and component units of the Commonwealth. We sincerely appreciate the dedicated efforts of all these individuals.

The report could not have been accomplished without the professionalism and dedication of Juan B. Torré Martínez, CPA, from our accounting team as well as the rest of the personnel of the Central Government

HACIENDA • ESTADO LIBRE ASOCIADO DE PUERTO RICO

SECRETARIO DE HACIENDA

Accounting area. Also, we would like to give special thanks to our independent auditors, KPMG LLP, for their advice and commitment.

This report continues our commitment to the people of the Commonwealth of Puerto Rico, the Governor, the Legislature, and the financial community to maintain our basic financial statements in conformance with the highest standards of financial accountability.

Respectfully submitted,

Angel Ortiz García
Acting Secretary of the Treasury

COMMONWEALTH OF PUERTO RICO

PRINCIPAL OFFICIALS

Aníbal Acevedo Vilá
Governor

Members of Cabinet

Jorge P. Silva Puras
Chief of Staff

Fernando J. Bonilla Ortiz
Secretary of State

Roberto J. Sánchez Ramos
Secretary of Justice

Ángel Ortiz García
Acting Secretary of the Treasury

Rafael Aragunde Torres
Secretary of Education

Román Velasco González
Secretary of Labor and Human Resources

Rosa Pérez Perdomo
Secretary of Health

Gabriel Figueroa Herrera
Secretary of Agriculture

Carlos González Miranda
Secretary of Transportation and Public Works

Bartolomé Gamundi Cestero
Secretary of Economic Development and Commerce

Félix Matos Rodríguez
Secretary of Family Affairs

Jorge Rivera Jiménez
Secretary of Housing

Javier Vélez Arocho
Secretary of Natural and Environmental Resources

Víctor A. Suárez Meléndez
Secretary of Consumer Affairs

David E. Bernier Rivera
Secretary of Sports and Recreation

Miguel A. Pereira Castillo
Secretary of Corrections and Rehabilitation

LEGISLATIVES OFFICERS

Kenneth D. McClintock Hernández
President, Senate

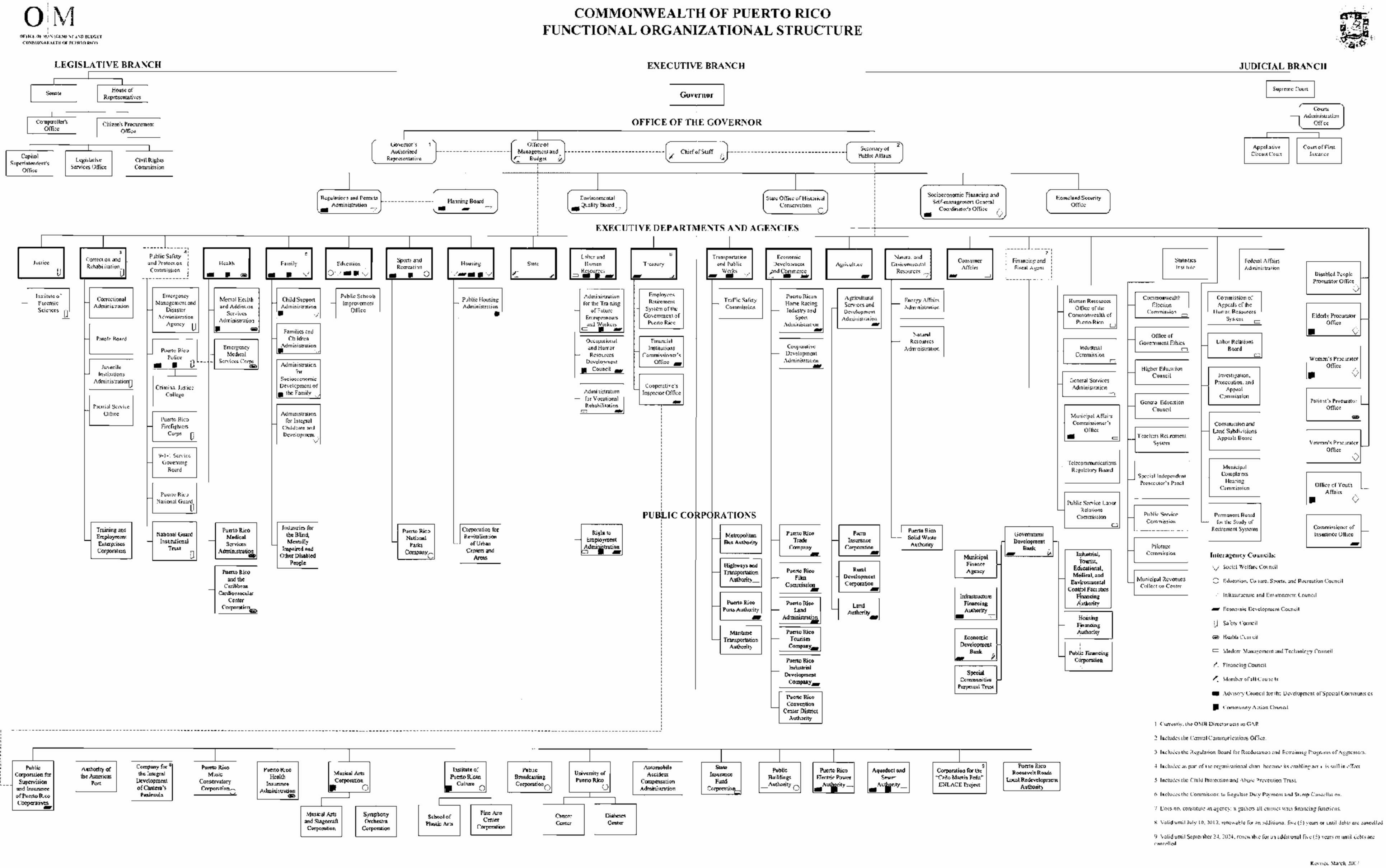
José F. Aponte Hernández
Speaker, House of Representatives

FISCAL OFFICERS

Armando A. Valdés Prieto
Director, Office of Management and Budget

Jorge Irizarry Herrans
President, Government Development Bank for Puerto Rico

COMMONWEALTH OF PUERTO RICO
FUNCTIONAL ORGANIZATIONAL STRUCTURE



FINANCIAL SECTION

Independent Auditors' Report

The Honorable Governor and Legislature of the
Commonwealth of Puerto Rico
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the year ended June 30, 2007, which collectively comprise the Commonwealth's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commonwealth's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Public Buildings Authority capital project fund or The Children's Trust special revenue fund (major funds), which represents 1% and 0%, respectively, of the assets and revenue of the government activities. We also did not audit the financial statements of the following activities, funds, and component units:

- Puerto Rico Public Housing Administration, the Office for the Improvements of Public Schools, Human Resources and Occupational Development Council, and the Office for the Administration of the Assets of the Urban Renovation and Housing Corporation of the Commonwealth of Puerto Rico, which collectively represent 17% and 3%, respectively, of the assets and revenue of the general fund and 6% and 5%, respectively, of the assets and revenue of the governmental activities,

- The Additional Lottery System, which represents 68% and 39%, respectively, of the assets and revenue of the lotteries fund and 13% and 29%, respectively, of the assets and revenue of the business-type activities;

- Public Buildings Authority special revenue and debt service funds, which collectively represent 5% and 1%, respectively, of the assets and revenue of the aggregate remaining fund information and 3% and 0%, respectively, of the assets and revenue of the governmental activities;

- The pension trust funds, which represents 74% and 93%, respectively, of the assets and revenue of the aggregate remaining fund information; and

- Entities identified in note 2 that are presented as discretely presented component units, which collectively represent 87% and 90%, respectively, of the assets and revenue of the aggregate discretely presented component units.

These financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the activities, funds, and component units indicated above, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Commonwealth'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, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico as of June 30, 2007, and the respective changes in financial position, and, where applicable, cash flows thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 3 through 20 and the schedule of funding progress on pages 154 through 155 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We and the other auditors 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The combining and individual fund financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. These financial statements and combining schedules have been subjected to the auditing procedures applied by us and the other auditors 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. The introductory and statistical sections of this report listed in the table of contents have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

KPMG LLP

June 15, 2008

Stamp No. 2222539 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

Management of the Commonwealth of Puerto Rico (the Commonwealth) provides this Management's Discussion and Analysis for the readers of the Commonwealth's basic financial statements. This narrative overview and analysis of the financial activities of the Commonwealth is for the fiscal year ended June 30, 2007, and is intended to provide an easily readable explanation of the information provided in the attached basic financial statements. We encourage readers to consider this information with the Commonwealth's basic financial statements that follow.

Financial Highlights – Primary Government

Government-wide Highlights

- The Commonwealth reported a deficit of $17.7 billion as of June 30, 2007, a deterioration in the financial position of $1.3 billion from last year's balances. The accumulated deficit is principally the result of the Commonwealth's practice of issuing debt and transferring such funds to its discretely presented component units in order for them to carry out the corresponding construction programs and to borrowings made by the primary government of the Commonwealth to cover operational needs.

- The Commonwealth's total deficit increased by $1.3 billion (a 8% increase) as a result of this year's operations. The governmental activities' deficit increased by $1.2 billion (a 7% increase), while net assets of the business-type activities showed a decrease of $20 million (an 3% decrease).

- The Commonwealth's governmental activities had total revenue of $15.1 billion, which were exceeded by total expenses of $16.7 billion, excluding transfers received from business-type activities amounting to $343 million.

- The Commonwealth's business-type activities had total revenue of $1.5 billion, which exceeded total expenses of $899 million, excluding transfers made to the governmental activities amounting to $343 million.

Fund Highlights

- As of June 30, 2007, the Commonwealth's governmental funds reported a combined ending fund balance of $107 million, a decrease of $304 million in comparison with the prior year, while the business-type activities decreased by $20 million to reach $757 million.

- The general fund reported a deficit of $511 million as of June 30, 2007, an increase of $127 million in comparison with the prior year.

- The unemployment insurance trust fund reported net assets of $459 million while the lotteries fund reported a deficit of $153 million. The deficit in the lottery funds was a result of the transfers of investments made to the general fund a few years ago.

Long-Term Debt

- Total long-term obligations as of June 30, 2007 were $28 billion, from which $2 billion are due within one year. The long-term obligation of the governmental activities increased by $1 billion (4%) to $28 billion when compared to the prior year, while the business-type activities decreased by $26 million

(7%) to $356 million. The increase in governmental activities' long-term obligations was mainly due to borrowings made by the Department of the Treasury of the Commonwealth to cover operational needs.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Commonwealth's basic financial statements. The Commonwealth's basic financial statements include three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains additional required supplementary information in addition to the basic financial statements themselves. These components are described below:

Basic Financial Statements

The basic financial statements include two kinds of financial statements that present different views of the Commonwealth—the government-wide financial statements and the fund financial statements and combining major component units financial statements. These financial statements also include the notes to the basic financial statements that explain some of the information in the financial statements and provide more detail.

Government-wide Financial Statements

The government-wide financial statements provide a broad view of the Commonwealth's operations in a manner similar to a private sector business. The statements provide both short- and long-term information about the Commonwealth's financial position, which assists in assessing the Commonwealth's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenue and expenses connected with the fiscal year even if cash involved has not been received or paid. The government-wide financial statements include two statements:

- ***Statement of Net Assets*** – This presents all of the government's assets and liabilities with the difference between the two reported as net assets (deficit). Over time, increases or decreases in the Commonwealth's net assets (deficit) may serve as a useful indicator of whether the financial position of the Commonwealth is improving or deteriorating.

- ***Statement of Activities*** – This presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenue and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenue for each function of the Commonwealth.

Both of the above financial statements have separate sections for three different types of Commonwealth programs or activities. These three types of activities are as follows:

- ***Governmental Activities*** – The activities in this section are mostly supported by taxes and intergovernmental revenue (federal grants). Most services normally associated with Commonwealth government fall into this category, including general government, public safety, health, public housing and welfare, education, and economic development.

• ***Business-Type Activities*** – These functions normally are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. These business-type activities of the Commonwealth include the operations of the following major funds: unemployment insurance trust fund (administered by the Commonwealth Employment Security Bureau) and the lotteries.

• ***Component Units*** – These are organizations that are legally separate from the Commonwealth, but either the Commonwealth is financially accountable for them or the nature and significance of their relationship with the Commonwealth are such that their exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. The Commonwealth has both blended and discretely presented component units.

• ***Blended Component Units*** – Although legally separate entities, these are in substance part of the primary government's operations. Therefore, data from blended component units are integrated into the appropriate funds for reporting purposes.

The Commonwealth's three blended component units are:

- Public Buildings Authority
- Puerto Rico Maritime Shipping Authority
- The Children's Trust

• ***Discretely Presented Component Units*** – These are operations for which the Commonwealth has financial accountability, but they have certain independent qualities as well. For the most part, these entities operate similar to private sector businesses and the business-type activities described above. The Commonwealth's discretely presented component units are presented in two categories, major and nonmajor. This separation is determined by the relative size of the entities' assets, liabilities, revenue, and expenses in relation to the total of all component units.

The Commonwealth's 36 discretely presented nonmajor component units are combined into a single column for reporting in the fund financial statements. Complete financial statements of the individual component units can be obtained from their respective administrative offices. Addresses and other additional information about the Commonwealth's component units are presented in note 1 to the basic financial statements.

The Commonwealth's eight discretely presented major component units are:

- Government Development Bank for Puerto Rico
- Puerto Rico Highways and Transportation Authority
- Puerto Rico Electric Power Authority
- Puerto Rico Aqueduct and Sewer Authority

- Puerto Rico Infrastructure Financing Authority
- Puerto Rico Health Insurance Administration
- Puerto Rico Sales Tax Financing Corporation
- University of Puerto Rico

The government-wide financial statements can be found immediately following this discussion and analysis.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other states and local governments, uses fund accounting to help ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements focus on individual parts of the Commonwealth government, reporting the Commonwealth's operations in more detail than the government-wide financial statements. All of the funds of the Commonwealth can be divided into three categories. It is important to note that these fund categories use different accounting approaches and should be interpreted differently. The three categories of funds are the following:

- ***Governmental Funds Financial Statements*** – Most of the basic services provided by the Commonwealth are financed through governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating the government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified-accrual basis of accounting. These statements provide a detailed short-term view of the Commonwealth's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Commonwealth. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenue, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities. These reconciliations are presented on the page immediately following each governmental fund financial statement.

  The Commonwealth has four major governmental funds. That is, each major fund is presented in a separate column in the governmental funds balance sheet and in the governmental funds statement of revenue, expenditures, and changes in fund balances. The Commonwealth's four major governmental funds are the general fund, The Children's Trust special revenue fund, the debt service fund, and the Public Buildings Authority capital projects fund. The remaining nonmajor governmental funds are grouped and presented in a single column in the governmental funds financial statements. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

- ***Proprietary Funds Financial Statements*** – These funds are used to show activities that operate more like those of commercial enterprises. Because these funds charge fees for services provided to outside customers including local governments, they are known as enterprise funds. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. Like the government-wide financial statements, proprietary fund financial statements use the accrual basis of accounting. There is no reconciliation needed between the government-wide financial statements for business-type activities and the proprietary fund financial statements. The Commonwealth has two major enterprise funds. As previously mentioned, they are the operations of the unemployment insurance trust fund (administered by the Commonwealth's Employment Security Bureau) and the lotteries. Other nonmajor proprietary funds are grouped and presented in a separate column in the proprietary funds financial statements. The basic proprietary funds financial statements can be found immediately following the governmental fund financial statements.

- ***Fiduciary Funds and Similar Component Units Financial Statements*** – These funds are used to account for resources held for the benefit of parties outside the Commonwealth government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the Commonwealth's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. They use the accrual basis of accounting. The Commonwealth's fiduciary funds are the pension trust funds (three separate retirement systems for employees, which are fiduciary component units of the Commonwealth) and the agency funds (which account for the assets held for distribution by the Commonwealth as an agent for other governmental units, other organizations, or individuals). The basic fiduciary funds and similar component units' financial statements can be found immediately following the proprietary funds financial statements.

Component Units Financial Statements

As mentioned above, these are operations for which the Commonwealth has financial accountability, but they have certain independent qualities as well, and they operate similar to private sector businesses. The government-wide financial statements present information for the component units in a single column on the statement of net assets. Also, some information on the statement of changes in net assets is aggregated for component units. The combining statements of net assets and the combining statement of activities provide detail for each major component unit and the nonmajor component units in aggregate. The basic combining financial statements for major component units can be found immediately following the fiduciary funds financial statements.

Notes to Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the component units' financial statements.

Required Supplementary Information

The basic financial statements include within its notes a section of required supplementary information. This section includes information of funding progress for the Commonwealth's three separate retirement systems.

Government-Wide Financial Analysis

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. Total assets and total liabilities of the Commonwealth's primary government at June 30, 2007 amounted to $14.6 billion and $32.3 billion, respectively, for a net deficit of $17.7 billion, compared to a $16.4 billion net deficit at the beginning of the current year, as restated.

A portion of the Commonwealth's net assets (deficit) reflects its investment in capital assets such as land, buildings, and equipment, less any related debt used to acquire those assets that are still outstanding. The Commonwealth uses these capital assets to provide services to its residents; consequentially, these assets are not available for future spending. Although the Commonwealth's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Commonwealth's net assets (deficit) represents resources that are subject to external restrictions on how they may be used. An otherwise positive remaining balance would be used to meet the Commonwealth's ongoing obligations to its residents and creditors. Internally imposed designations of resources are not presented as restricted net assets. At the end of the current fiscal year, the Commonwealth is able to report positive balances in two categories of net assets, and a deficit, both for the government as a whole as well as for its separate governmental and business-type activities.

As explained earlier, the net deficit of the primary government primarily results from the Commonwealth's practice of issuing debt and transferring such funds to the component units so that they can carry out the construction projects. The primary government retains the debt while the component units report the corresponding asset financed by such debt.

Total assets decreased by $248 million during fiscal year 2007 when compared to the prior fiscal year. This decrease is the net effect of various increases and decreases as follows:

- Unrestricted and restricted cash decreased by $1.1 billion when compared to the prior year. The decrease was mainly due to an increase of approximately $922 million in expenditures when compared to the prior year.

- Net increase of $535 million in the receivables was mainly due to the timing of cash collections when compared to prior year.

- Additions to capital assets, retirements, and depreciation expense amounted to approximately $478 million, $54 million, and $236 million, respectively.

(Continued)

Total liabilities increased $989 million during the current fiscal year when compared to the prior fiscal year. This fluctuation is mainly prompted by the issuance during fiscal year 2007 of Commonwealth's bonds amounting to $1.1 billion and an increase in the liabilities associated with compensated absences and legal claims totaling $1 billion and $175 million, respectively. The latter were offset by repayments of bonds of $303 million, compensated absences of $966 million and legal claims of $26 million.

Commonwealth's Net Assets – Primary Government

June 30, 2007

(Expressed in thousands)

		Governmental activities	Business-type activities	Total
Current assets	$	3,658,200	849,289	4,507,489
Capital assets		7,407,848	674	7,408,522
Other assets		2,389,190	297,636	2,686,826
Total assets	$	13,455,238	1,147,599	14,602,837
Current liabilities	$	6,658,987	151,299	6,810,286
Noncurrent liabilities		25,235,145	238,965	25,474,110
Total liabilities	$	31,894,132	390,264	32,284,396
Invested in capital assets, net of related debt	$	3,635,271	674	3,635,945
Restricted		331,051	910,479	1,241,530
Unrestricted		(22,405,216)	(153,818)	(22,559,034)
Total net assets (deficit)	$	(18,438,894)	757,335	(17,681,559)

(Continued)

Commonwealth's Net Assets – Primary Government

June 30, 2006

(Expressed in thousands)

		Governmental activities	Business-type activities	Total
Current assets	$	3,665,245	939,895	4,605,140
Capital assets		7,183,178	1,008	7,184,186
Other assets		2,817,053	255,993	3,073,046
Total assets	$	13,665,476	1,196,896	14,862,372
Current liabilities	$	6,378,707	149,673	6,528,380
Noncurrent liabilities		24,496,332	269,723	24,766,055
Total liabilities	$	30,875,039	419,396	31,294,435
Invested in capital assets, net of related debt	$	3,485,882	1,008	3,486,890
Restricted		280,078	947,507	1,227,585
Unrestricted		(20,975,523)	(171,015)	(21,146,538)
Total net assets (deficit)	$	(17,209,563)	777,500	(16,432,063)

The net assets of the governmental activities as of June 30, 2006 were restated by $14.7 million as a result of an underestimation of capital assets.

Changes in Net Assets

The Commonwealth's net deficit increased by $1.3 billion or 8% from last year's total net deficit. Approximately 52% of the Commonwealth's total revenue came from taxes, while 32% resulted from grants and contributions (primarily federal financial assistance). Charges for various goods and services provided represented 12% of the total revenue. The Commonwealth's expenses cover a range of services. The largest expenses were for education, public housing and welfare, public safety, and general government. In 2007, governmental activities' expenses exceeded program revenue by $11 billion, resulting in the use of $9.6 billion in general revenue (mostly taxes) and transfers. On the other hand, program revenue from business-type activities in 2007 exceeded expenses by approximately $285 million. Total governmental activities' expenses increased by $922 million when compared with 2006. Such increase was due to the effect of increases in expenses incurred in 2007 to fulfill the requirements of federal government grants and contributions in 2007 which increased by $548 million and normal increases in costs of goods and services. In addition, the business-type activities had unrestricted investments earnings of $37 million and transfer to the governmental activities amounting to $342 million.

Governmental activities increased the Commonwealth's net deficit by $1.2 billion. The Commonwealth implemented the sales and use tax during fiscal year 2007. This sales and use tax resulted in higher tax revenues. The Commonwealth expects that the effort to decrease expenses and the increase in tax revenue with the sales and use tax will eliminate or significantly lower the deficit in future years.

Business-type activities decreased the Commonwealth's net assets by $20 million.

(Continued)

Commonwealth of Puerto Rico's Changes in Net Assets – Primary Government

Year ended June 30, 2007

(Expressed in thousands)

		Governmental activities	Business-type activities	Total
Revenue:				
Program revenue:				
Charges for services	$	757,724	1,140,539	1,898,263
Operating grants and contributions		4,773,174	43,480	4,816,654
Capital grants and contributions		257,514	—	257,514
		5,788,412	1,184,019	6,972,431
General revenue:				
Income taxes		6,488,211	—	6,488,211
Excise taxes		1,475,311	—	1,475,311
Sales and use tax		583,639	—	583,639
Other taxes		4,663	—	4,663
Revenue from component units		381,336	—	381,336
Other		383,777	37,177	420,954
		9,316,937	37,177	9,354,114
Total revenue		15,105,349	1,221,196	16,326,545
Expenses:				
General government		2,847,596	—	2,847,596
Public safety		1,983,782	—	1,983,782
Health		1,943,582	—	1,943,582
Public housing and welfare		3,157,877	—	3,157,877
Education		4,748,008	—	4,748,008
Economic development		554,271	—	554,271
Intergovernmental		593,264	—	593,264
Interest and other		863,723	26,860	890,583
Lotteries		—	679,274	679,274
Unemployment		—	192,484	192,484
Total expenses		16,692,103	898,618	17,590,721
(Decrease) increase in net assets before transfers		(1,586,754)	322,578	(1,264,176)
Transfers		342,743	(342,743)	—
(Decrease) increase in net assets		(1,244,011)	(20,165)	(1,264,176)
Net assets (deficit), beginning of year (as restated)		(17,194,883)	777,500	(16,417,383)
Net assets (deficit), end of year	$	(18,438,894)	757,335	(17,681,559)

Commonwealth of Puerto Rico's Changes in Net Assets – Primary Government

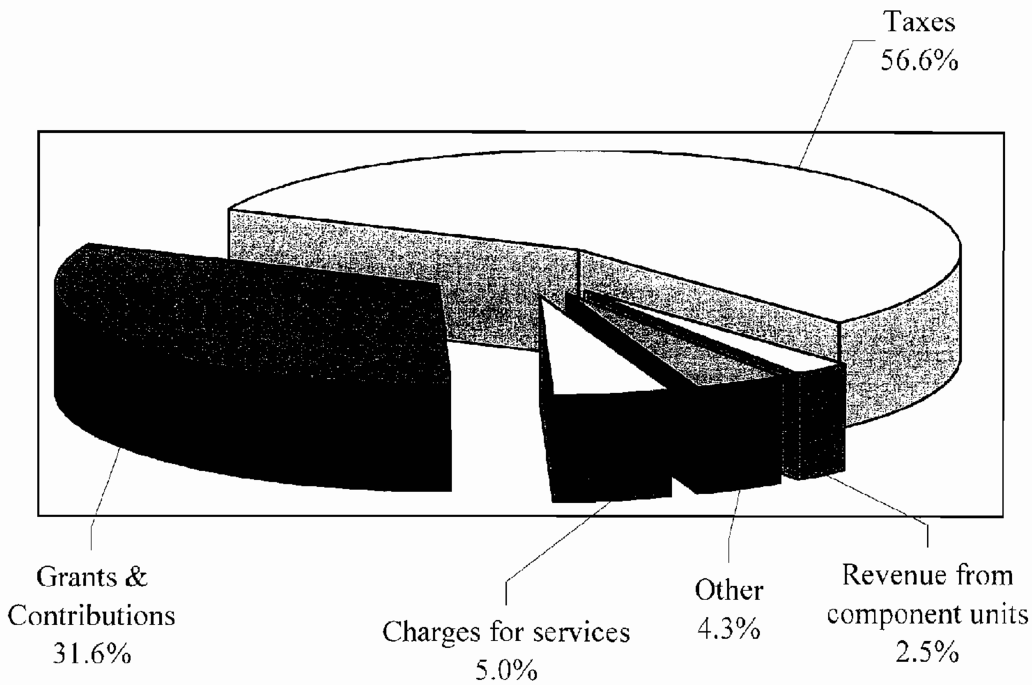
Year ended June 30, 2006

(Expressed in thousands)

	Governmental activities	Business-type activities	Total
Revenue:			
Program revenue:			
Charges for services	$ 828,993	1,149,426	1,978,419
Operating grants and contributions	4,365,711	59,613	4,425,324
Capital grants and contributions	100,990	—	100,990
	5,295,694	1,209,039	6,504,733
General revenue:			
Income taxes	6,255,391	—	6,255,391
Excise taxes	2,013,998	—	2,013,998
Other taxes	15,145	—	15,145
Revenue from component units	68,745	—	68,745
Other	601,225	33,165	634,390
	8,954,504	33,165	8,987,669
Total revenue	14,250,198	1,242,204	15,492,402
Expenses:			
General government	2,844,494	—	2,844,494
Public safety	2,217,294	—	2,217,294
Health	1,422,813	—	1,422,813
Public housing and welfare	3,287,559	—	3,287,559
Education	4,110,669	—	4,110,669
Economic development	564,447	—	564,447
Intergovernmental	440,390	—	440,390
Interest and other	882,163	25,043	907,206
Lotteries	—	670,425	670,425
Unemployment	—	207,483	207,483
Total expenses	15,769,829	902,951	16,672,780
(Decrease) increase in net assets before transfers	(1,519,631)	339,253	(1,180,378)
Transfers	242,642	(242,642)	—
(Decrease) increase in net assets	(1,276,989)	96,611	(1,180,378)
Net assets (deficit), beginning of year	(15,932,574)	680,889	(15,251,685)
Net assets (deficit), end of year	$ (17,209,563)	777,500	(16,432,063)

Revenue – Governmental Activities

Year ended June 30, 2007



Governmental Activities

Governmental activities increased the Commonwealth's net deficit to $18.4 billion. The decrease in net assets by the business-type activities is explained below. A comparison of the cost of services by function for the Commonwealth's governmental activities is shown below, along with the revenue used to cover the net expenses of the governmental activities (expressed in thousands).

Governmental Activities – Expenses Net of Program Revenue

Year ended June 30, 2007

(Expressed in thousands)

Net expense:	
General government	$ (2,274,426)
Public safety	(1,849,517)
Health	(1,081,383)
Public housing and welfare	(498,877)
Education	(3,269,028)
Economic development	(473,473)
Intergovernmental	(593,264)
Interest and other	(863,723)
Total governmental activities expenses, net program revenue	(10,903,691)
General revenue:	
Taxes	8,551,824
Revenue from component units	381,336
Transfers from business-type activities	342,743
Other revenue	383,777
Increase in governmental activities' net deficit	$ (1,244,011)

Business-Type Activities

The business-type activities decreased the Commonwealth's net assets by $20 million. This resulted from the decrease of approximately $20 million in contributions from federal government when compared to prior year.

Financial Analysis of the Commonwealth's Individual Funds

As noted earlier, the Commonwealth uses fund accounting to help ensure and demonstrate compliance with finance-related legal requirements.

(Continued)

Governmental Funds

The focus of the Commonwealth's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Commonwealth's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. As of the end of fiscal year 2007, the Commonwealth's governmental funds reported combined ending fund balance of $107 million, a decrease of net assets of $304 million in comparison with the prior year. The expenditures exceeded the revenues by $2.2 billion. However, this was offset by other financing sources amounting to $1.9 billion in the fund balance of the governmental funds. This year, the excess of expenditures over revenue increased by $368 million compared with the prior year. There is $993 million of fund balance reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate contracts and purchase orders of the prior fiscal year or (2) for a variety of other restricted purposes.

The general fund is the chief operating fund of the Commonwealth. At the end of the current fiscal year, unreserved fund deficit of the general fund was $1.5 billion, while the total fund balance has a total deficit of $511 million. The fund deficit of the Commonwealth's general fund increased by $127 million as a result of the current fiscal year's change in financial position. This is a 33% increase when compared to total fund balance reported in fiscal year 2006. Also, see additional related comments in the following section titled general fund budgetary highlights.

The debt service fund is the fund in which the Commonwealth accumulates the resources for the payment of the long-term debt. At end of the year, the fund balance of the debt service fund decreased by $20.7 million. Bonds and interest payable increased by $22 million or 6% compared with the prior year mainly due to the accumulation or resources for the payment of debt.

The PBA capital projects fund received resources only from transfers from other funds amounting to $146 million and had expenditures of $148 million, which resulted in a $2 million deficit in 2007. The total deficit at June 30, 2007 amounted to $34 million. The fund's total assets decreased $27 million or 47% compared with the prior year because of a decrease in cash in commercial banks, which was used to acquire capital assets.

The fund balance of The Children's Trust special revenue fund had a decrease of $45 million. The decrease was mainly due to a reduction in revenues. Particular of fiscal year 2006, there were $54 million transferred from GDB from investments related to QZAB bonds. No similar event occurred in the current year.

Although the revenue of other governmental funds (nonmajor) increased by $2 million or 2% during the year compared with the prior year, the expenditures increased by $226 million or 41%; the most significant increases in expenditures were noted in general government and intergovernmental activities of $53 million and $165 million, respectively. The fund had $546 million in other financing sources. All of the foregoing led to a net decrease of $109 million in the fund balance. Total assets of nonmajor funds decreased by $349 million or 28% compared with the prior year.

Proprietary Funds

The Commonwealth's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. As discussed in the business-type activities above, the Commonwealth's net assets decreased by $20 million as a result of operations in the proprietary funds. This resulted from a

$16.9 million increase in net assets by the lotteries fund, a decrease in net assets of $84.4 million by the unemployment insurance fund, and an increase of net assets of $47.4 million by the Commonwealth's other nonmajor enterprise funds.

General Fund Budgetary Highlights

Actual revenues of $8,718 million were fairly consistent with final budgeted revenues ($8,762 million). Nonetheless, actual revenues were $347 million less than originally budgeted ($9,065 million). The reduction is primarily attributable to (i) decrease in the gross national product, as reported by the Puerto Rico Planning Board, from 2.5% to 0.6%, (ii) the substitution of the sales and use tax for the 5% general excise tax, and (iii) certain income tax rate reductions included in the tax reform legislation approved on July 2006. The major categories of income affected with the abovementioned factors were the excise taxes with a decrease of $195.8 million, income taxes with $73.8 million, sales and use taxes with $60.4 million and charges for services with $44.8 million.

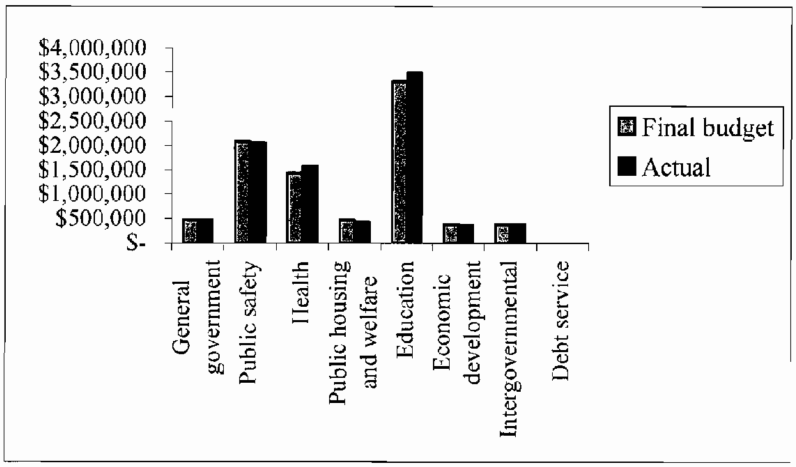
The actual expenditures reflected an increase of $238 million when compared to the final budgeted amounts. The excess in expenditures was predominantly caused by the Department of Education of the Commonwealth with $191 million, the Puerto Rico Health Insurance Administration with $174 million and the Puerto Rico Medical Service Administration with $50 million. These excess were partially neutralized by the savings achieved by the Executive Branch as part of the 10% budgetary reserve imposed to the agencies. Most of these variances were financed through the use of borrowings, approved by law or joint resolutions, from the Government Development Bank for Puerto Rico loans that provided resources of $340 million.

Expenditures – General Fund

Budget vs. Actual

Year ended June 30, 2007

(Expressed in thousands)



As of June 30, 2007, there was an excess of expenditures and other financing uses over revenue and other financing sources of $505 million.

Capital Assets and Debt Administration

Capital Assets

The Commonwealth's investment in capital assets for its governmental and business-type activities as of June 30, 2007 amounts to $10.1 billion, less accumulated depreciation of $2.7 billion, leaving a book value of $7.4 billion. This investment in capital assets includes land, buildings, building improvements, equipment, and construction in progress as infrastructure.

The net book value of capital assets at June 30, 2007 is distributed by function/activity in the following proportions: general government, 41%; public safety, 5%; health, 1%; public housing and welfare, 34%; education, 7%; and economic development, 12%. Actual capitalized assets were approximately $842 million for the year. Depreciation charges for the year totaled $236 million.

The infrastructure assets representing items that are normally immovable and of value only to the Commonwealth as roads, highways, bridges, toll facilities, water and sewer systems, lighting production, transmission and distribution systems, and similar items are principally owned by the component units of the Commonwealth. Therefore, the infrastructure assets are reported within depreciable capital assets under the discretely presented component units column. Additional information on the Commonwealth's capital assets can be found in note 12 to the basic financial statements that accompany this report.

(Continued)

Commonwealth's Capital Assets – Primary Government

June 30, 2007

(Expressed in thousands)

		Governmental activities	Business-type activities
Land	$	844,533	—
Construction in progress		1,434,978	—
Buildings and building improvements, net		4,553,568	—
Equipment, furniture, fixtures and vehicles, net		226,050	674
Infrastructure, net		348,719	—
Total capital assets	$	7,407,848	674

Debt Administration

General obligation bonds are backed by the full faith and credit of the Commonwealth, including the Commonwealth's power to levy additional taxes to help ensure repayment of the debt.

The Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit, and taxing power of the Commonwealth are not to be issued if the amount of the principal of, and interest on, such bonds and notes and on all such bonds and notes issued thereafter, which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual revenue raised under the provisions of Commonwealth legislation and conveyed into the treasury in the two fiscal years preceding the then current fiscal year. Section 2, Article VI of the Constitution of the Commonwealth does not limit the amount of debt that the Commonwealth may guarantee as long as the 15% limitation is not exceeded. At June 30, 2007, the Commonwealth is in compliance with the debt limitation requirement.

Moody's Investor Service lowered the rating on the Commonwealth's outstanding general obligation debt and appropriation debt from "Baa2" to "Baa3." Standard & Poor's Rating Services (S&P) had also lowered its rating on the Commonwealth's general obligation debt earlier in the year to BBB-, reflecting a long history of structural imbalance and the ongoing difficulties anticipated with further efforts to reduce the accrued deficit. The outlook was defined as stable.

The rating on the appropriation debt, typically rated one notch below the general obligation debt, has not been lowered, reflecting the improvements that have been made. S&P does not believe that Puerto Rico's appropriation credit is speculative grade.

S&P noted that Puerto Rico's debt, which is already high, is likely to increase. Although a major new revenue source of a 5.5% sales and use tax was added on November 16, 2006, balances remain difficult to achieve, requiring expense cuts and use of one-time revenue sources. Gap forecast suggests that balance will not be achieved until 2010, and that forecast is based on the expectation of flat expense growth.

(Continued)

Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

The Commonwealth's total long-term obligations increased by $1 billion during the current fiscal year, representing a 4% increase. Additional information on the Commonwealth's long-term obligations can be found in note 14 to the basic financial statements of this report.

Economic Factors and Next Year's Budgets and Rates

The average unemployment rate for the Commonwealth in 2007 was 10.4% down from the 2006 average rate of 11.7%. In terms of production, the real gross national product registered a decrease of 1.8%.

Based on the projections of the Puerto Rico Planning Board, the Puerto Rico economy is expected to reflect another decrease of 2.1% for the fiscal year 2008.

In an effort to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Executive Branch and the Legislature enacted and the Governor signed legislation providing for tax reform and fiscal reforms. The tax reform legislation is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based sales and use tax. The fiscal reform legislation is aimed at limiting expenditures in relation to past-spending rates and stabilizing expenditure growth at a level below that of recurring revenues.

On July 4, 2006, Act No. 117 (Act 117) was approved, which amends the Puerto Rico Internal Revenue Code of 1994 (the PR Code) to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the Central Government Sales Tax). Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5% (the Municipal Sales Tax and, together with the Central Government Sales Tax, the Sales Tax). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods) and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions, beginning during the tax year 2007, to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets. Act 117 repeals the 5.0% general excise tax imposed on imported goods and on goods manufactured in Puerto Rico. Certain items, such as fuel, crude oil and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items and will not be subject to the Sales Tax. The effective date of the repeal of the 5.0% general excise tax was October 17, 2006 pursuant to Act 229.

The Sales Tax became effective on November 15, 2006. Municipalities, however, were authorized to implement the Municipal Sales Tax starting on July 1, 2006. The revenues derived from the Sales Tax will be distributed as follows: (i) municipal governments will retain 1.5% of the Sales Tax, (ii) the Dedicated Sales Tax, created by Act No. 91 on May 13, 2006, as amended, will receive 1.0% of the Sales Tax, and (iii) the General Fund will receive 4.5% of the Sales Tax. The revenues to be generated by the Sales Tax will be partly offset by the partial elimination of the 5.0% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provided for special income tax rates with respect to certain transactions occurred on and between July 1, 2006 and December 31, 2006. These special tax rates will apply to eligible dividends declared by domestic corporations or partnerships and "built-in" gains associated with capital assets held for periods in excess of six months, as well as certain withdrawals from retirement accounts. These special tax rates are only available for transactions in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. In the case of resident corporations and partnerships, these special tax rates apply only to real property located in Puerto Rico.

The consolidated budget for the fiscal year 2006 – 07 amounts to $26.5 billion. From this amount, $20 billion is assigned to operating expenses, $3 billion to a permanent capital improvements program, and $3.5 billion for the debt service. For fiscal year 2007 – 08 the figures are: consolidated budget of $26.9 billion, of which $20.6 billion are assigned to operating expenses, $2.9 billion to the capital improvements program, and $3.5 billion to debt service.

Requests for Information

This financial report is designed to provide a general overview of the Commonwealth's finances for all of the Commonwealth's residents, taxpayers, customers, investors, and creditors. This financial report seeks to demonstrate the Commonwealth's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Department of the Treasury of the Commonwealth of Puerto Rico, Área de Contabilidad Central, P.O. Box 9024140, San Juan, PR 00902-4140.

COMMONWEALTH OF PUERTO RICO

Statement of Net Assets (Deficit)

June 30, 2007

(In thousands)

		Primary government			
		Governmental activities	**Business-type activities**	**Total primary government**	**Component units**
Assets:					
Cash and cash equivalents in commercial banks and U.S. Treasury	$	83,625	161,104	244,729	3,135,274
Cash and cash equivalents in governmental banks		935,071	610,870	1,545,941	629,592
Investments, including collateral from securities lending transactions		163,900	—	163,900	2,474,213
Receivables, net of allowance for uncollectibles:					
Taxes		1,275,882	—	1,275,882	—
Unemployment and other insurance premiums		—	58,884	58,884	108,709
Intergovernmental		716,561	—	716,561	30,856
Accounts		132,276	—	132,276	894,660
Loans and advances		6,207	—	6,207	4,815,273
Accrued interest		22,298	3,059	25,357	512,001
Other		118,647	14,796	133,443	523,190
Due from:					
Primary government		—	—	—	392,685
Component units		149,545	8,847	158,392	483,605
Other governmental entities		394	—	394	294,645
Internal balances		8,271	(8,271)	—	—
Inventories		37,774	—	37,774	370,144
Prepaid expenses		7,749	—	7,749	49,137
Restricted assets:					
Cash and cash equivalents in commercial banks		720,425	—	720,425	867,106
Cash and cash equivalents in governmental banks		1,392,826	—	1,392,826	798,283
Investments and other restricted assets		33,605	35,606	69,211	7,039,100
Long-term investments		—	—	—	1,564,448
Long-term receivables from:					
Loans		—	—	—	122,831
Interest-bearing deposits with other banks				—	5,174
Other		—	—	—	481
Long-term amounts due from:					
Primary government		—	—	—	102,925
Component units		—	220,326	220,326	1,073,250
Other governmental entities		—	—	—	31,617
Real estate held for sale or future development		55,434	—	55,434	249,164
Deferred expenses and other assets		186,900	41,704	228,604	490,477
Capital assets (net of accumulated depreciation):					
Land and other nondepreciable assets		2,279,511	—	2,279,511	9,043,126
Depreciable assets		5,128,337	674	5,129,011	18,664,972
Total assets	$	13,455,238	1,147,599	14,602,837	54,766,938

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Net Assets (Deficit)

June 30, 2007

(In thousands)

	Primary government			
	Governmental activities	Business-type activities	Total primary government	Component units
Liabilities:				
Accounts payable and accrued liabilities	$ 1,986,379	7,162	1,993,541	2,494,432
Deposits and escrow liabilities	—	—	—	6,174,210
Tax refunds payable	312,041	—	312,041	—
Due to:				
Primary government	—	—	—	151,464
Component units	388,744	—	388,744	498,968
Other governmental entities	3,211	—	3,211	23,294
Securities lending transactions and reverse repurchase agreements	—	—	—	812,877
Interest payable	564,623	—	564,623	497,168
Deferred revenue	108,970	26,900	135,870	124,454
Tax revenue anticipation notes payable	881,484	—	881,484	—
Due to primary government – long-term portion	—	—	—	227,254
Due to component units – long-term portion	—	—	—	1,051,379
Deferred revenue long-term portion	—	—	—	21,537
Insurance benefits payable	—	57,915	57,915	—
Liability for automobile accident insurance and workmen's compensation claims	—	—	—	806,102
Liabilities payable within one year:				
Commonwealth appropriation bonds	99,971	—	99,971	21,017
Bonds	318,380	—	318,380	685,753
Notes	748,338	—	748,338	1,230,548
Capital leases	4,808	—	4,808	—
Compensated absences	1,065,805	3,945	1,069,750	253,190
Lottery awards	—	55,377	55,377	—
Other long-term liabilities	176,233	—	176,233	120,008
Liabilities payable after one year:				
Commonwealth appropriation bonds	2,463,421	—	2,463,421	1,367,292
Bonds	12,900,146	—	12,900,146	20,705,232
Notes	2,780,665	—	2,780,665	3,665,209
Capital leases	137,003	—	137,003	—
Net pension obligation	5,096,324	—	5,096,324	—
Compensated absences	728,310	2,052	730,362	334,895
Lottery awards	—	236,913	236,913	—
Other long-term liabilities	1,129,276	—	1,129,276	344,546
Total liabilities	31,894,132	390,264	32,284,396	41,610,829
Net assets (deficit):				
Invested in capital assets, net of related debt	3,635,271	674	3,635,945	10,556,494
Restricted for:				
Trust – nonexpendable	—	—	—	1,404,008
Capital projects	11,601	298,309	309,910	1,136,460
Debt service	159,817	—	159,817	703,010
Payment of unemployment and related benefits	—	612,170	612,170	—
Affordable housing and related loan insurance programs	159,633	—	159,633	692,349
Student loans and other educational purposes	—	—	—	15,415
Other	—	—	—	190,318
Unrestricted deficit	(22,405,216)	(153,818)	(22,559,034)	(1,541,945)
Total net assets (deficit)	$ (18,438,894)	757,335	(17,681,559)	13,156,109

COMMONWEALTH OF PUERTO RICO

Statement of Activities

Year Ended June 30, 2007

(In thousands)

Functions	Expenses	Program revenue: Charges for services	Program revenue: Operating grants and contributions	Program revenue: Capital grants and contributions	Net (expense) revenue and changes in net assets: Primary government: Governmental activities	Net (expense) revenue and changes in net assets: Primary government: Business-type activities	Net (expense) revenue and changes in net assets: Primary government: Total	Net (expense) revenue and changes in net assets: Component units
Primary government:								
Governmental activities:								
Current:								
General government	$ 2,847,596	503,922	69,248	—	(2,274,426)	—	(2,274,426)	—
Public safety	1,983,782	51,900	82,219	146	(1,849,517)	—	(1,849,517)	—
Health	1,943,582	123,449	736,399	2,351	(1,081,383)	—	(1,081,383)	—
Public housing and welfare	3,157,877	24,643	2,497,540	136,817	(498,877)	—	(498,877)	—
Education	4,748,008	2,747	1,375,326	100,907	(3,269,028)	—	(3,269,028)	—
Economic development	554,271	51,063	12,442	17,293	(473,473)	—	(473,473)	—
Intergovernmental	593,264	—	—	—	(593,264)	—	(593,264)	—
Interest and other	863,723	—	—	—	(863,723)	—	(863,723)	—
Total governmental activities	16,692,103	757,724	4,773,174	257,514	(10,903,691)	—	(10,903,691)	—
Business-type activities:								
Lotteries	679,274	869,221	—	—	—	189,947	189,947	—
Unemployment insurance	192,484	243,571	6,580	—	—	57,667	57,667	—
Other	26,860	27,747	36,900	—	—	37,787	37,787	—
Total business-type activities	898,618	1,140,539	43,480	—	—	285,401	285,401	—
Total primary government	$ 17,590,721	1,898,263	4,816,654	257,514	(10,903,691)	285,401	(10,618,290)	—
Component units:								
Government Development Bank for Puerto Rico	$ 798,285	773,804	—	124,358	—	—	—	99,877
Puerto Rico Highways and Transportation Authority	929,314	280,435	—	126,718	—	—	—	(522,161)
Puerto Rico Electric Power Authority	3,798,245	3,680,390	—	—	—	—	—	(117,855)
Puerto Rico Aqueduct and Sewer Authority	821,742	755,538	23,162		—	—	—	(43,042)
Puerto Rico Infrastructure Financing Authority	146,168	—	—	—	—	—	—	(146,168)
Puerto Rico Health Insurance Administration	1,594,330	501,090	—	—	—	—	—	(1,093,240)
University of Puerto Rico	1,331,332	159,724	140,422		—	—	—	(1,031,186)
Puerto Rico Sales Tax Financing Corporation	240,238	—	—	—	—	—	—	(240,238)
Other component units	2,621,106	1,790,211	37,748	20,393	—	—	—	(772,754)
Total component units	$ 12,280,760	7,941,192	201,332	271,469	—	—	—	(3,866,767)
General revenue:								
Taxes:								
Income taxes					$ 6,488,211	—	6,488,211	—
Excise taxes					1,475,311	—	1,475,311	309,778
Sales and use tax					583,639	—	583,639	126,712
Other taxes					4,663	—	4,663	51,929
Revenue from global tobacco settlement agreement					69,604	—	69,604	—
Revenue from Puerto Rico Tourism Company					23,128	—	23,128	—
Revenue from Governing Board of 9-1-1 Services					9,191	—	9,191	—
Revenue from Puerto Rico Sales Tax Financing Corporation					240,238	—	240,238	—
Revenue from State Insurance Fund Corporation					39,175	—	39,175	—
Grants and contributions not restricted to specific programs					135,916	—	135,916	176,160
Payments from primary government					—	—	—	2,614,065
Unrestricted investment earnings					176,674	37,177	213,851	518,023
Gain on sale of assets					—	—	—	25,669
Other					71,187	—	71,187	56,350
Transfers					342,743	(342,743)	—	—
Total general revenue and transfers					9,659,680	(305,566)	9,354,114	3,878,686
Change in net assets					(1,244,011)	(20,165)	(1,264,176)	11,919
Net assets (deficit)– beginning of year (as restated)					(17,194,883)	777,500	(16,417,383)	13,144,190
Net assets (deficit) – end of year					$ (18,438,894)	757,335	(17,681,559)	13,156,109

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Balance Sheet – Governmental Funds

June 30, 2007

(In thousands)

Assets		General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
Cash and cash equivalents in commercial banks	$	39,481	—	—	—	44,144	83,625
Cash and cash equivalents in governmental banks		110,866	423,190	—	72,911	328,104	935,071
Investments		—	—	—	49,038	114,862	163,900
Receivables, net of allowance for uncollectibles:							
Taxes		1,275,882	—	—	—	—	1,275,882
Intergovernmental		704,776	11,785	—	—	—	716,561
Accounts		121,667	—	—	—	10,609	132,276
Loans		6,171	—	—	—	36	6,207
Accrued interest		20,205	1,327	—	317	449	22,298
Other		278	—	—	—	—	278
Due from:							
Other funds		61,446	—	—	—	178,011	239,457
Component units		105,471	—	—	—	44,074	149,545
Other governmental entities		—	—	—	—	394	394
Restricted assets:							
Cash and cash equivalents in commercial banks		540,571		29,754	—	150,100	720,425
Cash and cash equivalents in governmental banks		1,392,826	—	—	—	—	1,392,826
Other assets		33,605	—	—	—	—	33,605
Real estate held for sale or future development		39,196	—	—	—	16,238	55,434
Total assets	$	4,452,441	436,302	29,754	122,266	887,021	5,927,784

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Balance Sheet – Governmental Funds

June 30, 2007

(In thousands)

Liabilities and fund balances		General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
Liabilities:							
Accounts payable and accrued liabilities	$	1,870,992	5,689	63,976	932	76,684	2,018,273
Tax refunds payable		312,041	—	—	—	—	312,041
Due to:							
Other funds		231,186	—	—	—	—	231,186
Other governmental entities		3,211	—	—	—	—	3,211
Component units		368,370	—	—	—	20,374	388,744
Notes payable		169,963	—	—	—	129,112	299,075
Bonds payable		—	208,460	—	—	75,690	284,150
Interest payable		55,395	194,118	—	—	82,041	331,554
Deferred revenues		1,070,957	—	—	—	—	1,070,957
Tax revenue anticipation notes payable		881,484	—	—	—	—	881,484
Total liabilities		4,963,599	408,267	63,976	932	383,901	5,820,675
Fund balances (deficit):							
Reserved for:							
Encumbrances		744,950	—	—	—	97,721	842,671
Debt service		—	28,035	—	—	—	28,035
Capital projects		13,797	—	—	—	—	13,797
Assets in liquidation		74,940	—	—	—	—	74,940
Low income housing assistance		159,633	—	—	—	—	159,633
Unreserved (deficit):							
General fund		(1,504,478)	—	—	—	—	(1,504,478)
Debt service funds		—	—	—	—	131,782	131,782
Special revenue funds		—	—	—	121,334	15,952	137,286
Capital projects funds		—	—	(34,222)	—	257,665	223,443
Total fund balances (deficit)		(511,158)	28,035	(34,222)	121,334	503,120	107,109
Total liabilities and fund balances (deficit)	$	4,452,441	436,302	29,754	122,266	887,021	5,927,784

COMMONWEALTH OF PUERTO RICO

Reconciliation of the Balance Sheet to the Statement of Net Assets –
Governmental Funds

Year ended June 30, 2007

(In thousands)

Amounts reported for governmental activities in the statement of net assets are different because:		
Total fund balances of governmental funds	$	107,109
Inventories and prepaid expenses that are not available to pay for current period expenditures and therefore are not recognized in the funds		45,523
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds		7,407,848
Long-term account receivable from global tobacco settlement agreement and PBA		118,369
Deferred revenue in governmental funds that are recognized as revenue in the governmental activities		961,987
Debt issued by the Commonwealth have associated costs that are paid from current available resources in the funds. However, these costs are deferred on the statement of net assets		182,536
Net pension asset of the Puerto Rico Judiciary Retirement System recognized in governmental activities is not a financial resource and, therefore, is not reported in the funds		4,364
Liabilities, including appropriation bonds ($2,563,392), bonds payable ($12,934,376), notes payable ($3,229,928), capital leases payable, ($141,811), compensated absences ($1,769,803), net pension obligation ($5,096,324), and other long-term liabilities ($1,297,927) are not due and payable in the current period and therefore are not reported in the funds		(27,033,561)
Interest liabilities are not due and payable in the current period and, therefore, are not reported in the funds		(233,069)
Deficit of governmental activities	$	(18,438,894)

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Revenue, Expenditures, and Changes in Fund Balances –
Governmental Funds

Year ended June 30, 2007
(In thousands)

	General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
Revenue:						
Taxes:						
Income taxes	$ 6,389,973	—	—	—	—	6,389,973
Excise taxes	1,475,311	—	—	—	—	1,475,311
Sales and use tax	583,639	—	—	—	—	583,639
Other taxes	4,663	—	—	—	—	4,663
Charges for services	757,724	—	—	—	—	757,724
Revenue from global tobacco settlement agreement	—	—	—	—	68,665	68,665
Revenues from component units:						
Governing Board of 9-1-1 Services	9,191	—	—	—	—	9,191
Tourism Company of Puerto Rico	23,128	—	—	—	—	23,128
Puerto Rico Sales Tax Financing Corporation	223,282	—	—	—	16,956	240,238
State Insurance Fund Corporation	39,175	—	—	—	—	39,175
Intergovernmental	5,029,854	120,441	—	—	16,309	5,166,604
Interest and investment earnings	148,638	8,518	—	7,376	12,142	176,674
Other	39,725	8,638	—	—	5,264	53,627
Total revenue	14,724,303	137,597	—	7,376	119,336	14,988,612
Expenditures:						
Current:						
General government	2,313,735	—	—	—	224,264	2,537,999
Public safety	1,863,148	—	—	—	1,108	1,864,256
Health	1,940,520	—	—	622	7,059	1,948,201
Public housing and welfare	3,046,812	—	—	—	1,773	3,048,585
Education	4,356,304	—	—	20,514	23,503	4,400,321
Economic development	512,966		—	1,381	18,906	533,253
Intergovernmental	426,352	—	—	—	166,895	593,247
Capital outlays	308,370	—	148,009	—	56,445	512,824
Debt service:						
Principal	608,410	208,474	—	—	87,720	904,604
Interest and other	219,419	408,980	—	253	174,990	803,642
Debt issuance costs	—	2,751	—	—	8,330	11,081
Total expenditures	15,596,036	620,205	148,009	22,770	770,993	17,158,013
Excess of expenditures over revenue	(871,733)	(482,608)	(148,009)	(15,394)	(651,657)	(2,169,401)
Other financing sources (uses):						
Transfers in	774,480	82,386	145,813	243	162,153	1,165,075
Transfers out	(414,916)	—	—	(71,627)	(335,789)	(822,332)
Long-term debt issued	381,791	—	—	42,000	716,565	1,140,356
Capital leases	2,975	—	—	—	—	2,975
Refunding bonds issued	—	379,498	—	—	—	379,498
Total other financing sources (uses)	744,330	461,884	145,813	(29,384)	542,929	1,865,572
Net change in fund balances (deficit)	(127,403)	(20,724)	(2,196)	(44,778)	(108,728)	(303,829)
Fund balances (deficit) at beginning of year	(383,755)	48,759	(32,026)	166,112	611,848	410,938
Fund balances (deficit) at end of year	$ (511,158)	28,035	(34,222)	121,334	503,120	107,109

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances to the Statement of Activities – Governmental Funds

Year ended June 30, 2007

(In thousands)

Amounts reported for governmental activities in the statement of activities are different because:		
Net change in fund balances – total governmental funds	S	(303,829)
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays ($517,572) exceeded depreciation ($235,691) in the current period.		281,881
Impairment of capital assets are expensed in the statement of activities but not reported in the governmental funds as such impairment does not require the use of current financial resources.		(3,421)
Revenue in the statement of activities that do not provide current financial resources are not reported as revenue in the governmental funds.		18,499
Debt proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount by which net proceeds ($1,522,750) exceeded repayments ($904,604).		(618,146)
Income tax revenue that are not currently available are deferred in the governmental funds, but are accruable as revenue in the statement of activities. This is the amount by which deferred revenue increased during the year.		98,239
Governmental funds do not report transfers of long-term assets or liabilities because such transfers do not represent financial resources; however, they are recorded in the statement of activities. This amount represents the transfer of property by the Commonwealth to certain municipalities (note 12).		(28,659)
Generally, inventory and prepayments are recorded as expenditures in the governmental funds when purchased rather than capitalized as an asset. However, these assets are capitalized in the statement of net assets. This is the sum of the increase in inventory ($14,764) and net pension asset ($2,921) for the year.		11,843
Debt issuance costs are expenditures to governmental funds, but are deferred assets in the statement of net assets. This is the amount of debt issue costs for the year.		11,081
Certain interest and other costs reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This is the amount equivalent to the increase in interest payable ($60,234), combined with the amortization of debt issue costs ($11,220), and the net accretion and amortization of debt issue discount and deferred losses ($34,996).		(106,450)
Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds. This is the amount by which the net increases in net pension obligation ($351,154), accrued compensated absences ($110,162), and liability for claims and judgments ($149,109) exceeded the net decreases in Christmas bonus liability ($2,488) and liability in federal cost disallowances ($2,888).		(605,049)
Change in deficit of governmental activities	$	(1,244,011)

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Revenue and Expenditures – Budget and Actual –
Budget Basis – General Fund

Year ended June 30, 2007

(In thousands)

		Original budget	Amended budget	Actual	Variance
Revenue:					
Income taxes	$	6,261,000	6,238,000	6,187,115	(50,885)
Excise taxes		1,673,000	1,489,000	1,477,178	(11,822)
Other taxes		109,000	101,000	103,073	2,073
Sales and use taxes		643,000	576,000	582,560	6,560
Charge for services		245,000	214,000	200,200	(13,800)
Intergovernmental		14,000	15,000	14,504	(496)
Revenue from component units		24,000	24,000	23,128	(872)
Other		96,000	105,000	129,864	24,864
Total revenue		9,065,000	8,762,000	8,717,622	(44,378)
Expenditures:					
Current:					
General government		476,391	480,976	471,385	9,591
Public safety		2,059,411	2,077,070	2,053,900	23,170
Health		1,428,648	1,432,705	1,580,444	(147,739)
Public housing and welfare		478,586	479,342	439,626	39,716
Education		3,311,426	3,313,911	3,494,585	(180,674)
Economic development		374,245	380,324	363,512	16,812
Intergovernmental		382,608	382,859	382,054	805
Total expenditures		8,511,315	8,547,187	8,785,506	(238,319)
Excess (deficiency) of revenue over (under) expenditures		553,685	214,813	(67,884)	(282,697)
Other financing sources (uses):					
Notes payable issued		—	—	339,564	339,564
Transfer in		98,000	121,000	144,829	23,829
Transfer out		(976,686)	(940,813)	(921,373)	19,440
Total other financing sources (uses)		(878,686)	(819,813)	(436,980)	382,833
Excess of expenditures and other financing uses over revenue and other financing sources	$	(325,001)	(605,000)	(504,864)	100,136

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Net Assets – Proprietary Funds

June 30, 2007

(In thousands)

Assets		Unemployment insurance	Lotteries	Other proprietary	Total
Current assets:					
Cash and cash equivalents in commercial banks	$	—	57,897	103,207	161,104
Cash and cash equivalents in governmental banks		461,945	68,866	80,059	610,870
Receivable, net:					
Insurance premiums, net		54,284	—	4,600	58,884
Component units		—	—	8,847	8,847
Accrued interest		569	—	2,490	3,059
Other		8,929	5,443	424	14,796
Total current assets		525,727	132,206	199,627	857,560
Noncurrent assets:					
Loans receivable from component units, excluding current portion, net		—	—	220,326	220,326
Due from other funds		—	53,175	—	53,175
Restricted investments		—	—	35,606	35,606
Capital assets, net		—	674	—	674
Other		—	39,994	1,710	41,704
Total assets	$	525,727	226,049	457,269	1,209,045
Liabilities and Net Assets (Deficit)					
Current liabilities:					
Accounts payable and accrued liabilities	$	—	4,675	2,487	7,162
Due to other funds		—	61,446	—	61,446
Deferred revenue		10,156	16,716	28	26,900
Compensated absences		—	2,346	1,599	3,945
Lottery awards		—	55,377	—	55,377
Insurance benefits payable		56,781	—	1,134	57,915
Total current liabilities		66,937	140,560	5,248	212,745
Noncurrent liabilities:					
Compensated absences		—	1,720	332	2,052
Lottery awards		—	236,913	—	236,913
Total liabilities	$	66,937	379,193	5,580	451,710
Net assets (deficit):					
Invested in capital assets	$	—	674	—	674
Restricted for:					
Payment of insurance benefits		458,790	—	153,380	612,170
Capital projects		—	—	298,309	298,309
Unrestricted		—	(153,818)	—	(153,818)
Total net assets (deficit)	$	458,790	(153,144)	451,689	757,335

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Revenue, Expenses and Changes in Net Assets –
Proprietary Funds

Year ended June 30, 2007

(In thousands)

		Unemployment insurance	Lotteries	Other proprietary funds	Total
Operating revenues:					
Lottery ticket sales	$	—	869,168	—	869,168
Insurance premiums		243,571	—	20,313	263,884
Interest		—	—	7,434	7,434
Other		—	53	—	53
Total operating revenues		243,571	869,221	27,747	1,140,539
Operating expenses:					
Lottery awards		—	544,138	—	544,138
Insurance benefits		192,484	—	4,510	196,994
General, administrative, and other operating expenses		—	134,802	22,350	157,152
Depreciation and amortization		—	334	—	334
Total operating expenses		192,484	679,274	26,860	898,618
Operating income		51,087	189,947	887	241,921
Nonoperating revenue:					
Contributions from federal government		6,580	—	36,900	43,480
Interest and investment earnings		27,872	7,097	2,208	37,177
Total nonoperating revenue		34,452	7,097	39,108	80,657
Income before transfers		85,539	197,044	39,995	322,578
Transfers from general fund		—	16,863	7,458	24,321
Transfers to general fund		(169,933)	(197,044)	(87)	(367,064)
Net change in net assets (deficit)		(84,394)	16,863	47,366	(20,165)
Net assets (deficit) at beginning of year		543,184	(170,007)	404,323	777,500
Net assets (deficit) at end of year	$	458,790	(153,144)	451,689	757,335

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Cash Flows –
Proprietary Funds

Year ended June 30, 2007

(In thousands)

		Unemployment insurance	Lotteries	Other proprietary	Total
Cash flows from operating activities:					
Receipts from customers and users	$	244,304	868,280	23,855	1,136,439
Other receipts		—	53	15,429	15,482
Payments to suppliers and employees		—	(138,084)	(22,217)	(160,301)
Payment of lottery prizes		—	(555,550)	—	(555,550)
Payments of insurance benefits		(205,537)	—	(4,623)	(210,160)
Other payments		—	—	(50,874)	(50,874)
Net cash provided by (used in) operating activities		38,767	174,699	(38,430)	175,036
Cash flows from noncapital financing activities:					
Intergovernmental grants and contributions		6,580	—	36,900	43,480
Transfers from general fund		—	—	7,458	7,458
Transfers to other funds		(146,923)	(176,242)	(87)	(323,252)
Net cash provided by (used in) noncapital financing activities		(140,343)	(176,242)	44,271	(272,314)
Cash flows from investing activities:					
Interest received on deposits and investments		27,870	7,097	2,178	37,145
Purchases of investments		—	—	(2,133)	(2,133)
Net cash provided by (used in) investing activities		27,870	7,097	45	35,012
Net increase (decrease) in cash and cash equivalents		(73,706)	5,554	5,886	(62,266)
Cash and equivalents at beginning of year		535,651	121,209	177,380	834,240
Cash and cash equivalents at end of year	$	461,945	126,763	183,266	771,974
Reconciliation of operating income to net cash provided by (used in) operating activities:					
Operating income	$	51,086	189,947	887	241,920
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:					
Depreciation and amortization		—	334	—	334
Interests earned on deposits loans and investments		—	—	(173)	(173)
Changes in operating assets and liabilities:					
Decrease (increase) in accounts and loans receivable		2,322	(888)	(37,468)	(36,034)
Decrease in other assets		—	378	11	389
Decrease in obligation for unpaid lottery awards		—	(11,412)	—	(11,412)
Decrease in due to other funds		—	(2,269)	—	(2,269)
Increase (decrease) in deferred revenues		(1,589)	(2,299)	2	(3,886)
Increase (decrease) in compensated absences		—	(251)	(1,186)	(1,437)
Increase (decrease) in liability for insurance benefits payable		(13,052)	—	(113)	(13,165)
Increase (decrease) in accounts payable and accrued liabilities		—	1,159	(390)	769
Total adjustments		(12,319)	(15,248)	(39,317)	(66,884)
Net cash provided by (used in) operating activities	$	38,767	174,699	(38,430)	175,036

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Fiduciary Net Assets

June 30, 2007

(In thousands)

Assets		Pension trust	Special deposits – agency
Cash and cash equivalents in commercial banks			
and U.S. Treasury	$	77,642	653,310
Cash and cash equivalents in governmental banks:			
Unrestricted		269,953	189,454
Restricted		2,310	—
Investments:			
Debt and equity securities, at fair value		4,618,650	—
Other		94,470	15,606
Receivables, net:			
Accounts		119,890	—
Loans and advances		941,691	—
Accrued interest and dividends		9,668	—
Due from general fund		4,615	—
Other		31,639	—
Capital assets, net		34,366	—
Other assets		8,071	—
Total assets		6,212,965	858,370
Liabilities			
Accounts payable and accrued liabilities		75,701	858,370
Other liabilities		1,570	—
Total liabilities		77,271	858,370
Net Assets			
Net assets held in trust for pension and other benefits	$	6,135,694	—

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Changes in Fiduciary Net Assets – Pension Trust Funds

Year ended June 30, 2007

(In thousands)

Additions:		
Contributions:		
Sponsor	$	497,346
Participants		469,428
Special		156,453
Total contributions		1,123,227
Interest and investment income:		
Interest		135,045
Dividends		28,372
Net change in fair value of investments		782,754
Investment expenses		(19,349)
Net interest and investment income		926,822
Other income		21,171
Total additions		2,071,220
Deductions:		
Pension and other benefits		1,255,681
Refunds of contributions		38,790
General and administrative		62,123
Total deductions		1,356,594
Net change in net assets held in trust for pension and other benefits		714,626
Net assets held in trust for pension and other benefits:		
Beginning of year		5,421,068
End of year	$	6,135,694

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Net Assets –
Major Component Units

June 30, 2007

(In thousands)

Assets	Major Component Units									
	Government Development Bank for Puerto Rico	**Puerto Rico Aqueduct and Sewer Authority**	**Puerto Rico Electric Power Authority**	**Puerto Rico Health Insurance Administration**	**Puerto Rico Highways and Transportation Authority**	**Puerto Rico Infrastructure Financing Authority**	**Puerto Rico Sales Tax Financing Corporation**	**University of Puerto Rico**	**Total nonmajor component units**	**Total component units**
Assets:										
Current assets:										
Cash and cash equivalents in commercial banks	$ 2,821,798	45,420	40,441	49,821	37,299	—	—	9,108	131,387	3,135,274
Cash and cash equivalents in governmental banks	—	514	—	—	30,270	41,076	—	42,534	515,198	629,592
Investments, including collateral from securities lending transactions	794,926	—	—	—	—	—	—	—	1,679,287	2,474,213
Receivables, net:										
Insurance premium	—	—	—	—	—	—	—	—	108,709	108,709
Intergovernmental	—	6,104	—	—	—	—	—	22,330	2,422	30,856
Accounts	—	115,562	543,225	—	9,414	—	16,737	14,367	195,355	894,660
Loans and advances	4,755,973	—	—	—	—	—	—	—	59,300	4,815,273
Accrued interest	469,702	—	6,481	194	—	1,818	319	—	33,487	512,001
Other governmental entities	—	74,043	128,046	20,610	—	11,569	—	—	60,377	294,645
Other	—	—	109,261	11,459	—	34,226	—	73,214	295,030	523,190
Due from:										
Primary government	—	—	145,218	148,900	—	—	—	23,355	75,212	392,685
Component units	411,374	—	31,909	—	—	—	—	19,337	20,985	483,605
Inventories	—	16,912	308,739	—	—	—	—	6,438	38,055	370,144
Prepaid expenses	—	742	6,177	189	2,881	808	—	23,527	14,813	49,137
Total current assets	9,253,773	259,297	1,319,497	231,173	79,864	89,497	17,056	234,210	3,229,617	14,713,984
Noncurrent assets:										
Restricted assets:										
Cash and cash equivalents in commercial banks	82,755	124,341	427,236	—	2,355	87,695	—	11,455	131,269	867,106
Cash and cash equivalents in governmental banks		33,166		—	37,922	20,171	110,778	3,525	592,721	798,283
Investments and other restricted assets	1,381,798	—	581,977	—	823,001	1,956,429	—	360,261	1,935,634	7,039,100
Investments	—	—	—	—	—	—	—	—	1,564,448	1,564,448
Receivables:										
Loans, interest, and other	—	—	—	—	—	—	—	2,975	119,856	122,831
Interest-bearing deposits with other banks	—	—	—	—	—	—	—	—	5,174	5,174
Other governmental entities	—	—	—	—	—	—	—	—	31,617	31,617
Other	—	—	—	—	—	—	—	—	481	481
Due from:										
Primary government	—	—	30,427	—	—	—	—	72,498	—	102,925
Component units	1,064,208	—	—	—	—	—	—	—	9,042	1,073,250
Real estate held for sale and future development	66,688	—	—	—	—	—	—	—	182,476	249,164
Capital assets, not being depreciated	10,971	1,039,907	2,348,484	—	2,997,138	1,228,334	—	140,147	1,278,145	9,043,126
Capital assets, depreciable, net	13,554	4,207,861	3,406,084	571	8,242,044	173	—	660,198	2,134,487	18,664,972
Deferred expenses and other assets	53,337	29,136	127,985	—	160,371	60,923	—	—	58,725	490,477
Total noncurrent assets	2,673,311	5,434,411	6,922,193	571	12,262,831	3,353,725	110,778	1,251,059	8,044,075	40,052,954
Total assets	$ 11,927,084	5,693,708	8,241,690	231,744	12,342,695	3,443,222	127,834	1,485,269	11,273,692	54,766,938

See accompanying notes to basic financial statements.

(Continued)

COMMONWEALTH OF PUERTO RICO

Combining Statement of Net Assets –
Major Component Units

June 30, 2007

(In thousands)

Liabilities and Net Assets	**Government Development Bank for Puerto Rico**	**Puerto Rico Aqueduct and Sewer Authority**	**Puerto Rico Electric Power Authority**	**Puerto Rico Health Insurance Administration**	**Puerto Rico Highways and Transportation Authority**	**Puerto Rico Infrastructure Financing Authority**	**Puerto Rico Sales Tax Financing Corporation**	**University of Puerto Rico**	**Total nonmajor component units**	**Total component units**
	Major Component Units									
Liabilities:										
Current liabilities:										
Accounts payable and accrued liabilities	$ 103,361	301,139	653,162	146,948	141,560	89,771	—	115,454	943,037	2,494,432
Deposits and escrow liabilities	5,469,794	5,429	159,104	—	—	—	—	—	539,883	6,174,210
Due to:										
Primary government	—	9,027	—	27,600	—	—	—	—	114,837	151,464
Component units	—	76,054	41,732	—	—	1,364	—	15,368	364,450	498,968
Other governmental entities	—	—	—	—	—	—	—	41	23,253	23,294
Securities lending transactions and reverse repurchase agreements	455,000	—	—	—	—	—	—	—	357,877	812,877
Interest payable	48,311	10,591	102,935	—	139,136	63,249	—	5,833	127,113	497,168
Deferred revenue	—	21,901	—	—	—	77	—	36	102,440	124,454
Notes payable, current portion	692,846	—	387,277	—	—	—	—	—	150,425	1,230,548
Commonwealth appropriation bonds, current portion	39	18,409	—	—	—	40	—	—	2,529	21,017
Bonds payable, current portion	70,698	19,989	361,694	—	66,020	32,225	—	22,790	113,882	687,298
Compensated absences	5,015	12,386	95,882	453	15,985	128	—	24,920	98,421	253,190
Workers compensation claims	—	—	—	—	—	—	—	—	687,829	687,829
Liability for automobile accident benefit payments	—	—	—	—	—	—	—	—	118,273	118,273
Current portion of other long-term liabilities	—	—	78,226	—	3,393	—	—	1,100	37,289	120,008
Total current liabilities	6,845,064	474,925	1,880,012	175,001	366,094	186,854	—	185,542	3,781,538	13,895,030
Noncurrent liabilities:										
Due to:										
Primary government	—	220,146	—	—	—	—	—	—	7,108	227,254
Component units	—	63,470	7,757	—	—	51,926	303,024	21,903	603,299	1,051,379
Deferred revenue	—	—	—	—	—	—	—	—	21,537	21,537
Notes payable	1,587,067	250,000	467,784		—				1,360,358	3,665,209
Commonwealth appropriation bonds	10,160	1,052,759	—	—	—	10,467	—	—	293,906	1,367,292
Bonds payable	1,212,556	1,276,664	5,286,015	—	6,939,230	3,065,378	—	715,062	2,208,782	20,703,687
Compensated absences	997	54,165	128,714	302	10,691	222	—	119,608	20,196	334,895
Other long-term liabilities	—	63,595	—	—	31,940	6,000	—	79,727	163,284	344,546
Total noncurrent liabilities	2,810,780	2,980,799	5,890,270	302	6,981,861	3,133,993	303,024	936,300	4,678,470	27,715,799
Total liabilities	9,655,844	3,455,724	7,770,282	175,303	7,347,955	3,320,847	303,024	1,121,842	8,460,008	41,610,829
Net assets:										
Invested in capital assets, net of related debt	24,525	2,987,685	168,307	571	4,281,724	1,228,507	—	231,026	1,634,149	10,556,494
Restricted for:										
Trust – nonexpendable	—	—	—		—	1,341,602	—	62,406	—	1,404,008
Capital projects	—	—	315,154	—	71,674	624,911	—	24,791	99,930	1,136,460
Debt service	25,504	—	—	—	630,893	14,362	(175,190)	56,234	151,207	703,010
Affordable housing and related loan insurance programs	274,422	—	—	—	—		—	—	417,927	692,349
Student loans and other educational purposes	—	—	—	—	—	—	—	7,686	7,729	15,415
Other specified purposes	—	19,284		—	—	18,886	—	32,136	120,012	190,318
Unrestricted (deficit)	1,946,789	(768,985)	(12,053)	55,870	10,449	(3,105,893)	—	(50,852)	382,730	(1,541,945)
Total net assets (deficit)	2,271,240	2,237,984	471,408	56,441	4,994,740	122,375	(175,190)	363,427	2,813,684	13,156,109
Total liabilities and net assets (deficit)	$ 11,927,084	5,693,708	8,241,690	231,744	12,342,695	3,443,222	127,834	1,485,269	11,273,692	54,766,938

COMMONWEALTH OF PUERTO RICO

Combining Statement of Activities –
Major Component Units

Year ended June 30, 2007

(In thousands)

	Program revenues				Net revenues (expenses) and changes in net assets	General revenues									
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions		Payments from primary government	Payments from (to) component units	Contributions not restricted to specific programs	Taxes	Interest and investment earnings	Gain on sale of assets	Other	Change in net assets	Net assets, beginning of year	Net assets, (deficit) end of year
Major component units:															
Government Development Bank for Puerto Rico	$ 798,285	773,804	—	124,358	99,877	65,850	608	—	—	—	—	8,469	174,804	2,096,436	2,271,240
Puerto Rico Aqueduct and Sewer Authority	821,742	755,538	23,162	—	(43,042)	700	43,648	—	—	7,650	—	5,212	14,168	2,223,816	2,237,984
Puerto Rico Electric Power Authority	3,798,245	3,680,390	—	—	(117,855)	—	—	57,137	—	20,942	—	—	(39,776)	511,184	471,408
Puerto Rico Health Insurance Administration	1,594,330	501,090	—	—	(1,093,240)	1,142,347	—	—	—	4,129	—	—	53,236	3,205	56,441
Puerto Rico Highways and Transportation Authority	929,314	280,435	—	126,718	(522,161)	—	—	—	302,871	29,185	—	—	(190,105)	5,184,845	4,994,740
Puerto Rico Infrastructure Financing Authority	146,168	—	—	—	(146,168)	98,320	125	—	—	93,737	—	—	46,014	76,361	122,375
Puerto Rico Sales Tax Financing Corporation	240,238	—	—	—	(240,238)	—	(62,786)	—	126,712	1,122	—	—	(175,190)	—	(175,190)
University of Puerto Rico	1,331,332	159,724	140,422	—	(1,031,186)	861,503	70,338	115,955	—	9,116	—	7,486	33,212	330,215	363,427
Nonmajor component units	2,621,106	1,790,211	37,748	20,393	(772,754)	445,345	(51,933)	3,068	58,836	352,142	25,669	35,183	95,556	2,718,128	2,813,684
	$ 12,280,760	7,941,192	201,332	271,469	(3,866,767)	2,614,065	—	176,160	488,419	518,023	25,669	56,350	11,919	13,144,190	13,156,109

See accompanying notes to basic financial statements.

(1) Summary of Significant Accounting Policies

The Commonwealth of Puerto Rico (the Commonwealth) was constituted on July 25, 1952, under the provisions of its Constitution as approved by the people of Puerto Rico and the U.S. Congress. The Commonwealth's Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government. The Commonwealth assumes responsibility for public safety, health, public housing and welfare, education, and economic development.

The accompanying basic financial statements of the Commonwealth have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The accompanying basic financial statements present the financial position of the Commonwealth and its various funds, the results of operations of the Commonwealth and its various funds and fund types, and the cash flows of the proprietary funds. The basic financial statements are presented as of June 30, 2007 and for the year then ended. The basic financial statements include the various departments, agencies, boards, commissions, public trusts and public corporations, and any other organizational units governed by the Puerto Rico Legislature and/or officers of the Commonwealth.

(a) The Financial Reporting Entity

The accompanying basic financial statements include all departments, agencies, and governmental entities whose funds are under the custody and control of the Secretary of the Treasury of the Commonwealth and the Commonwealth's component units pursuant to Act No. 230 of July 23, 1974, as amended, known as Commonwealth of Puerto Rico Accounting Law. The Commonwealth has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Commonwealth to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Commonwealth.

As required by U.S. GAAP, these basic financial statements present the Commonwealth and its component units.

(b) Component Units

Component units are entities that are legally separate organizations for which the Commonwealth's elected officials are financially accountable or other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading and incomplete. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Commonwealth's balances and transactions; or discrete presentation of the component units' financial data in columns separate from the Commonwealth's balances and transactions. The Commonwealth is financially accountable because it appoints the members of the governing authorities of each of the component units and because it is able to impose its will on these organizations or because the organizations provide financial benefits or impose financial burdens on the Commonwealth. The financial statements of the component units discussed below have been included in the financial reporting entity either as blended component units or as discretely presented component units in accordance with GASB Statement No. 14, *The Financial Reporting Entity*, as amended by GASB Statement No. 39, *Determining Whether Certain Organization are Component Units.*

Blended Component Units

The following entities, while legally separate from the Commonwealth, meet the criteria to be reported as part of the primary government because they provide services entirely or almost entirely to the Commonwealth.

Public Buildings Authority (PBA) – PBA is governed by a six-member board comprised by the Secretary of the Department of Transportation and the Public Works (DTPW), the Secretary of the Department of Education of the Commonwealth, the Interim President of the Government Development Bank for Puerto Rico (GDB), and three members appointed by the Governor of Puerto Rico with the advice and consent of the Senate. It is a legally separate entity, whose activities are blended within the primary government because it exists to construct, purchase, or lease office, school, health, correctional, social welfare, and other facilities for lease to the Commonwealth's departments, component units, and instrumentalities. Bonds issued by PBA to finance such facilities are payable from lease collections, which are largely derived from Commonwealth appropriations and are further secured by the Commonwealth's guaranty.

Puerto Rico Maritime Shipping Authority (PRMSA) – PRMSA is governed by the President of GDB. The operations of PRMSA consist of servicing the long-term liability to third parties that resulted from the sale of certain maritime operations formerly owned and operated by PRMSA. The Commonwealth is required to annually appropriate funds in its general operating budget to provide for the payment of principal and interest on such debt [see note 14 (d)].

The Children's Trust (the Trust) – The Trust is governed by a seven-member board comprised by the Governor, who designated the president of the board, the President of GDB, the Director of the Office of Management and Budget (OMB) of the Commonwealth, the Secretary of Justice of the Commonwealth, and three private citizens appointed by the Governor with the consent of the Senate. The Trust's sole operation consists of providing financial assistance principally to the Commonwealth's departments to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico, especially in the areas of education, recreation, and health. The operation of the Trust is financed with the moneys being received by the Commonwealth from a global settlement agreement (GSA) dated November 23, 1998 between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies shall continue making contributions in perpetuity.

The blended component units are composed of various funds. The PBA capital projects fund and the Trust special revenue fund are presented as major governmental funds. All other funds are reported in the other governmental funds column. Complete financial statements of the blended component units can be obtained directly by contacting their respective administrative offices at:

Public Buildings Authority
P.O. Box 41029 Minillas Station
San Juan, PR 00940-1029

Puerto Rico Maritime
Shipping Authority
P.O. Box 42001
San Juan, PR 00940-2001

The Children's Trust
P.O. Box 42001
San Juan, PR 00940-2001

Discretely Presented Component Units

The following component units, consistent with GASB No. 14, are discretely presented in the basic financial statements because of the nature of the services they provide, the Commonwealth's ability to impose its will, principally through the appointment of their governing authorities, and because the component units provide specific financial benefits to, or impose financial burdens on, the Commonwealth. These have been classified by management between major and nonmajor component units. A major discretely presented component unit is defined as those component units that meet ten percent or more of total assets, liabilities, net assets, revenue or expenses of all discretely presented component units. If a component unit is expected to meet the minimum criteria for inclusion as major component unit in a future year, the Commonwealth may elect to report as a major component unit.

Major Component Units

Government Development Bank for Puerto Rico (GDB) – GDB is governed by a seven-member board appointed by the Governor. GDB acts as fiscal agent, depository of funds, disbursing agent, investor and financial advisor for the Commonwealth, its public corporations, and municipalities in connection with the issuance of bonds and notes; and it also makes loans and advances funds predominantly to the Commonwealth's departments, component units, and municipalities. GDB's board of directors' members are executives on a trustworthy position, named and supervised by the Governor.

Puerto Rico Aqueduct and Sewer Authority (PRASA) – PRASA is governed by a nine-member board comprising five members appointed by the Governor, the Secretary of DTPW, the President of GDB, and two members elected in a referendum carried out by the Puerto Rico Consumer Affairs Department. PRASA owns and operates the system of public water supply and sanitary sewer facilities. PRASA is authorized, among other things, to borrow money and issue revenue bonds for any of its corporate purposes. Through the approval of Act No. 328 of 1998, as discussed in note 15(a), the Commonwealth guarantees the principal and interest payments of certain outstanding bonds and of all future bonds issued to refinance those outstanding bonds, and other loans under the State Revolving Fund Program (SRFP).

Puerto Rico Electric Power Authority (PREPA) – PREPA is governed by a nine-member board comprising the Secretary of DTPW, six members appointed by the Governor with the consent of the Senate, and two members representing the consumers' interest elected in a referendum carried out by the Puerto Rico Consumer Affairs Department. Board members are appointed or elected for a period of four years. PREPA is responsible for conserving, developing, and utilizing the power resources of Puerto Rico and owns and operates the Commonwealth's electrical power generation, transmission, and distribution system. The Commonwealth provides financial support to PREPA through legislative appropriation.

Puerto Rico Health Insurance Administration (PRHIA) – PRHIA is governed by a nine-member board comprising the Secretary of Health of the Commonwealth, the Secretary of the Treasury of the Commonwealth, and the Insurance Commissioner of Puerto Rico, being these members inherent by law, and six additional members appointed by the Governor, with the consent of the Senate. PRHIA was created for implementing, administering, and negotiating a health insurance system through contracts with insurance underwriters to provide quality medical and hospital care to low-income individuals, employees of the Commonwealth, and policemen who voluntarily subscribe to the Puerto Rico health insurance medical plan. The board of directors' president is elected by the Governor and all board of directors' members is executives on a trustworthy position. The Commonwealth provides financial support to PRHIA through legislative appropriations.

Puerto Rico Highways and Transportation Authority (PRHTA) – PRHTA is governed by the Secretary of DTPW. PRHTA has broad powers to carry out its responsibilities in accordance with DTPW's overall transportation policies. These powers include, among other things, the complete control and supervision of any highway facilities constructed, owned, or operated by PRHTA, the ability to set tolls for the use of the highway facilities, and the power to issue bonds, notes, or other obligations. PRHTA plans and manages the construction of all major projects relating to the Commonwealth's toll highway system, undertakes major repairs, and maintains the toll ways. The Commonwealth has the ability to significantly influence rates charged by PRHTA.

Puerto Rico Infrastructure Financing Authority (PRIFA) – PRIFA is governed by the board of directors of GDB and the Secretary of the Treasury of the Commonwealth. Its responsibilities are to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other component units and governmental instrumentalities of the Commonwealth, which are authorized to develop infrastructure facilities and to establish alternate means for financing them. PRIFA's boards of directors' members are executives on a trustworthy position, named and supervised by the Governor. The Commonwealth provides financial support to PRIFA through legislative appropriations.

Puerto Rico Sales Tax Financing Corporation (known as COFINA by its Spanish acronym) – COFINA was created by Act No. 291 of December 26, 2006 as an independent governmental instrumentality to own and hold the dedicated sales tax fund (known as FIA by its Spanish acronym), for the purpose of financing the repayments and refundings of the Commonwealth's extra-constitutional debt. The FIA Fund was created by Act No. 91 of May 13, 2006 to receive and account for the first 1% of the new sales and use tax established as described in note 3(c). The members of the board of directors of COFINA are the same as the ones of GDB.

University of Puerto Rico (UPR) – UPR is governed by a thirteen-member board of trustees comprising one full-time student, two permanent professors, and ten community citizens of the private sector, of which at least one must be graduated from the institution. Community citizens are designated by the Governor with the advice and consent of the Senate. Members designated by the Governor are appointed for a period of four to eight years. The terms for the student and professors are one year. The Commonwealth provides financial support to UPR through legislative appropriations.

Nonmajor Component Units

Agricultural Services and Development Administration (ASDA) – ASDA is governed by the Secretary of Agriculture of the Commonwealth. The purpose of ASDA is to provide a wide variety of services and incentives to the agricultural sector. The government has the ability to impose its will. The Commonwealth provides financial support to ASDA through legislative appropriations.

Automobile Accidents Compensations Administration (AACA) – AACA is governed by a four-member board appointed by the Governor with the advice and consent of the Senate. AACA operates a system of compulsory insurance coverage for all registered motor vehicles and compensates citizens for injuries arising from motor vehicle accidents. The Commonwealth has the ability to significantly influence rates charged by AACA.

Cardiovascular Center Corporation of Puerto Rico and the Caribbean (CCCPRC) – CCCPRC is governed by a five-member board comprising of the Secretary of Health of the Commonwealth, the Director of the Medical Sciences Campus of the UPR, the Executive Director of the Puerto Rico Medical Services Administration, and two additional members appointed by the Governor with the consent of the Senate, one of which should be from the Cardiology Society of Puerto Rico and another a member of a cardiology foundation properly registered in the Department of State of the Commonwealth. The purpose of the CCCPRC is to provide special treatment to patients suffering from cardiovascular diseases. The Commonwealth provides financial support to CCCPRC through legislative appropriations.

Caribbean Basin Projects Financing Authority (CBPFA) – CBPFA is governed by a seven-member board comprising of the Secretary of State of the Commonwealth, the Executive Director of the Puerto Rico Industrial Development Company (PRIDCO), the President of GDB, the President of the Economic Development Bank for Puerto Rico (EDB), and three citizens, including at least two from the private sector, appointed by the Governor with the advice and consent of the Senate. CBPFA is authorized to issue revenue bonds and to lend the proceeds thereof to finance projects for the development of the Caribbean Basin countries that were authorized to receive investments of funds under the provisions of Section 936 of the U.S. Internal Revenue Code. The Commonwealth has access to CBPFA's resources.

Culebra Conservation and Development Authority (CCDA) – CCDA is a component unit of the Commonwealth created by Law No. 66 of June 22, 1975, as amended, to formulate, adopt, and administer the program and plan for the conservation, use, and development of natural resources of the municipality of Culebra. CCDA is administered through a board of directors composed of seven members, including the Mayor of Culebra. The administration and operations of the CCDA are conducted by an executive director elected by the board of directors.

(Continued)

Economic Development Bank for Puerto Rico (EDB) – EDB is governed by a nine-member board comprising the President of GDB, who is the Chairman, the Secretary of Agriculture of the Commonwealth, the Secretary of the Department of Economic Development and Commerce of the Commonwealth, the Executive Director of the Puerto Rico Industrial Development Company, the Executive Director of the Tourism Company of Puerto Rico, and four other members representing the private sector and appointed by the Governor with the consent of the Senate. Private sector members are appointed for a maximum period of three years. EDB is responsible for the promotion and development of the private sector economy of the Commonwealth. This purpose is to be met by granting direct loans, loan guarantees, loan participation, and/or direct investments to any person or business organization devoted to manufacturing, agriculture, trade, tourism, or other service enterprises with preference to but not limited to economic activities that may have the effect of substituting imports. The Commonwealth has the ability to impose its will on this component unit.

Employment and Training Enterprises Corporation (ETEC) – ETEC is governed by a consultant board, which includes two private citizens appointed by the Governor with the consent of the Senate. The purpose of ETEC is to provide training, management, development, and employment for inmates of the correctional institutions of the Commonwealth. The Commonwealth provides financial support to ETEC through legislative appropriations.

Farm Insurance Corporation of Puerto Rico (FICPR) – FICPR is governed by a five-member board consisting of the Secretary of Agriculture of the Commonwealth, the Dean of the Agricultural Sciences Faculty of the UPR Mayaguez Campus, a representative of GDB, and two bona fide farmers appointed by the Governor with the consent of the Senate. The purpose of the FICPR is to provide insurance to farmers against losses in their farms caused by natural disasters.

Fine Arts Center Corporation (FACC) – FACC is governed by a nine-member board comprising the President of the Musical Arts Corporation and eight members named by the Governor. FACC was created with the purpose of administering the Fine Arts Center. The Commonwealth provides financial support to FACC through legislative appropriations.

Governing Board of the 9-1-1 Service (911 Service) – The Governing Board of 911 Service (the Board) is governed by a five-member board comprising the Chief of Police, the Executive Director of the Medical Emergency Services, the Director of the State Emergency Management Agency, the Chief of the Puerto Rico Firefighters Corps, and one member appointed by consensus of the four ex-officio members to represent the public interest. The 911 Service is responsible for providing an efficient service of fast response to emergency calls through the 911 number and transferring these to the appropriate response agencies using technological and human resources to safeguard lives and properties. The Commonwealth has access to 911 Service's resources.

Institute of Puerto Rican Culture (IPRC) – The Institute is governed by a nine-member board comprising the President of Musical Arts Corporation and eight members appointed by the Governor with the advice and consent of the Senate. The Institute is responsible for implementing the public policy related to the development of Puerto Rican arts, humanities and culture. The Commonwealth provides financial support to IPRC through legislative appropriations.

(Continued)

Institutional Trust of the National Guard of Puerto Rico (ITNGPR) – ITNGPR is governed by a seven-member board comprising of the National Guard Special Assistant, the President of GDB, the Secretary of Justice of the Commonwealth, three militaries from the Puerto Rico National Guard, and one representative from the community recommended by the National Guard Special Assistant and appointed by the Governor. ITNGPR's purpose is to provide life insurance, retirement benefits, and economic assistance to the active members of the Puerto Rico National Guard and their families. The Commonwealth provides financial support to ITNGPR through legislative appropriations.

Land Authority of Puerto Rico (LAPR) – LAPR is governed by a six-member board consisting of the Secretary of Agriculture of the Commonwealth and five members appointed by the Governor. LAPR was created to carry out the provisions of the Land Law of Puerto Rico. LAPR maintains debt that is paid with Commonwealth's appropriations.

Musical Arts Corporation (MAC) – MAC is governed by a seven-member board appointed by the Governor with the consent of the Senate. MAC was created to promote the development of the arts and cultural programs of the Commonwealth. The Commonwealth provides financial support to MAC through legislative appropriations.

National Parks Company of Puerto Rico (NPCPR) – NPCPR is governed by a nine-member board comprising the Secretary of Recreation and Sports of the Commonwealth (the Secretary), who is the chairman, the Secretary of Education of the Commonwealth, the Executive Director of the Puerto Rico Tourism Company (PRTC), the Secretary of Natural and Environmental Resources of the Commonwealth, and five members appointed by the Governor with the recommendation from the Secretary and with known interest in the development and preservation of parks in the private sector. NPCPR is responsible for the operation of all national parks and the protection, conservation, maintenance and use of parks, beaches, forests, and natural and historical monuments for the optimum enjoyment of present and future generations. The Commonwealth provides financial support to NPCPR through legislative appropriations.

Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives (PCSDIPRC) – PCSDIPRC is governed by a nine-member board consisting of the Administrator of the Cooperative Development Administration, the Commissioner of Financial Institutions of Puerto Rico (the Commissioner of Financial Institutions), the Secretary of the Treasury of the Commonwealth, the Inspector of Cooperatives, three citizens representing the cooperative movement one representative of the Puerto Rico Cooperatives League, and one private citizen representing the public interest. PCSDIPRC has the responsibility of providing to all the cooperatives and the Federation of Cooperatives of Puerto Rico insurance coverage over the stocks and deposits, for monitoring the financial condition of the insured cooperatives, and of uninsured cooperatives when requested by the Commissioner of Financial Institutions.

Puerto Rico Conservatory of Music Corporation (PRCMC) – PRCMC is governed by a six-member board appointed by the Governor, with the consent of the Senate. PRCMC is responsible for providing the Puerto Rican community and especially its youths with the required facilities to educate and perfect their musical skills, including secondary education programs for developing musical arts. It prepares the artistic element that nourishes the Puerto Rico Symphony Orchestra and other musical organizations, and coordinates the governmental efforts to interested industries, private enterprises, and particular citizens. The Commonwealth provides financial support to PRCMC through legislative appropriations.

Puerto Rico Convention Center District Authority (PRCCDA) – PRCCDA is governed by a board comprising of nine members, four of which shall be from the public sector and five from the private sector. The public sector members comprise the Secretary of Economic Development and Commerce of the Commonwealth, who is the Chairman, the Executive Director of the PRTC, the president of GDB, and one member from the public sector. The private sector members are individuals having experience in the areas of hospitality, tourism, real estate, or convention centers who are appointed by the Governor with the advice and consent of the Senate. PRCCDA was created to develop, own, finance, plan, design, construct, operate, manage, and promote the new Puerto Rico Convention Center and the Puerto Rico Convention District. The PRCCDA also has the ownership interest as well as other rights and obligations related to the development and operations of the Jose Miguel Agrelot Coliseum. The Commonwealth provides financial support to PRCCDA through legislative appropriations.

Puerto Rico Council on Higher Education (PRCHE) – PRCHE is governed by a board comprising eight members appointed by the Governor with the consent of the Senate and the Secretary of Education of the Commonwealth as an ex-officio member. Its purpose is to develop higher education, to administer the licensing and certification of institutions of higher education, and to administer scholarship funds. The Commonwealth provides financial support to PRCHE through legislative appropriations.

Puerto Rico Government Investment Trust Fund (PRGITF) – PRGITF is governed by the Secretary of the Treasury of the Commonwealth. GDB is its trustee, custodian, and administrator. PRGITF's main objective is to provide investment opportunities in a professionally managed money market portfolio by investing in high-quality securities with minimal credit risk. Qualified investors include the Commonwealth's central government, its public corporations, instrumentalities and agencies, and the municipalities of Puerto Rico. In conformity with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*, the financial statements of the PRGITF are not included in the accompanying basic financial statements because the primary government and each component unit investor is already presenting as cash or investment their corresponding share of the assets of the PRGITF (see note 5).

Puerto Rico Industrial Development Company (PRIDCO) – PRIDCO is governed by a seven-member board comprising the Secretary of Economic Development and Commerce of the Commonwealth, who is the Chairman, the Secretary of the Treasury of the Commonwealth, the President of GDB, the President of the Planning Board of Puerto Rico, and three members from the private sector appointed by the Governor with the advice and consent of the Senate. The private sector members are appointed for a period of four years. PRIDCO administers the Commonwealth-sponsored economic development program by providing facilities, general assistance, and special incentive grants to manufacturing companies operating in Puerto Rico. PRIDCO has issued interim notes and revenue bonds to finance manufacturing plants and other facilities. Rentals derived from the leasing of specified facilities of PRIDCO are pledged for the payment of PRIDCO's revenue bonds. PRIDCO maintains debt that is paid with Commonwealth's appropriations.

Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (known as AFICA by its Spanish acronym) – AFICA is governed by a seven-member board consisting of the Secretary of Economic Development and Commerce, the President of GDB, the Executive Director of PRIFA, the Executive Director of the PRTC, the President of the Environmental Quality Board, and two private citizens appointed by the Governor. AFICA is authorized to issue revenue bonds to finance industrial, tourist, environmental control, medical, and educational facilities in Puerto Rico and the United States of America for use by private companies, nonprofit entities, or governmental agencies. The bonds are payable solely from collections from such private companies, nonprofit entities, or governmental agencies, and do not constitute debt of the Commonwealth or any of its other component units. The Commonwealth has access to AFICA's resources. AFICA maintains debt that is paid with Commonwealth's appropriations.

Puerto Rico Land Administration (PRLA) – PRLA is governed by an eight-member board comprising the Secretary of Economic Development and Commerce of the Commonwealth, who serves as president, the Secretary of the Treasury of the Commonwealth, the Secretary of Agriculture of the Commonwealth, the Secretary of DTPW of the Commonwealth, the Secretary of Housing of the Commonwealth, the President of the Planning Board of Puerto Rico, and two other members appointed by the Governor with the consent of the Senate. PRLA acquires parcels of land on behalf of government instrumentalities through negotiation or expropriation. The Commonwealth provides financial support to the PRLA through legislative appropriations.

Puerto Rico Medical Services Administration (PRMSA) – PRMSA is governed by a ten-member board comprising the Secretary of Health of the Commonwealth, who is the Chairman, the Dean of the Medical Sciences Faculty of the UPR, the President of the Board of the Puerto Rican Cancer Society, the Mayor of the municipality of San Juan, the Administrator of the State Insurance Fund Corporation (SIFC), the Executive Director of PRMSA, the Administrator of the Administration of Mental Health and Anti-Addiction Services, the President of the Medical Policy and Administration Committee, and two consumers appointed by the Secretary of Health of the Commonwealth. Its purpose is to plan, organize, operate, and administer the centralized health services, provided in support of the hospital and other functions, offered by the member institutions and users of the medical complex known as the Puerto Rico Medical Center. The Commonwealth provides financial support to PRMSA through legislative appropriations.

Puerto Rico Metropolitan Bus Authority (PRMBA) – PRMBA is governed by the Secretary of DTPW of the Commonwealth. PRMBA provides bus transportation to passengers within the San Juan Metropolitan Area. The Commonwealth provides financial support to PRMBA through legislative appropriations.

Puerto Rico Municipal Finance Agency (PRMFA) – PRMFA is governed by a five-member board comprising the President of GDB, who is the Chairman, the Commissioner of Municipal Affairs, and three additional members appointed by the Governor, one of whom shall be either the mayor or chief financial officer of a municipality. PRMFA was organized to create a capital market to assist the municipalities of Puerto Rico in financing their public improvement programs.

(Continued)

Puerto Rico Ports Authority (PRPA) – PRPA is governed by a five-member board consisting of the Secretary of DTPW of the Commonwealth, who is the Chairman, the Secretary of Economic Development and Commerce of the Commonwealth, the Administrator of the Economic Development Administration, the Executive Director of the PRTC, and one private citizen appointed by the Governor with the consent of the Senate. The purpose of PRPA is to administer all ports and aviation transportation facilities of the Commonwealth and to render other related services. The Commonwealth provides financial support to PRPA through legislative appropriations.

Puerto Rico Public Broadcasting Corporation (PRPBC) – PRPBC is governed by an eleven-member board of directors comprising the Secretary of Education of the Commonwealth, the President of the UPR, the Executive Director of IPRC, and eight private citizens appointed by the Governor with the advice and consent of the Senate. At least three of these private citizens must have proven interest, knowledge, and experience in education, culture, art, science, or radio and television. PRPBC was created for the purpose of integrating, developing, and operating the radio, television, and electronic communication facilities that belong to the Commonwealth. The Commonwealth provides financial support to PRPBC through legislative appropriations.

Puerto Rico School of Plastic Arts (PRSPA) – PRSPA is governed by a seven-member board. Four members are appointed by the board of directors of IPRC, representing the public educational and cultural interests. Board members may not be employees of the PRSPA. The remaining three members are elected from among the members of the board of directors of IPRC, one of whom will serve as president. PRSPA was created to develop, promote, plan, and coordinate programs of study in higher education oriented to the plastic arts, teaching, artistic techniques, and to help students to develop humanistic values. The Commonwealth provides financial support to PRSPA through legislative appropriations.

Puerto Rico Solid Waste Authority (PRSWA) – PRSWA is governed by a government board appointed by the Secretary of the Department of Natural Resources, whereby, the Secretary and the Executive Director of PRSMA periodically meet. PRSWA provides alternatives for processing of solid waste and encourages recycling, reuse, and recovery of resources from waste. The Commonwealth provides financial support to PRSWA through legislative appropriations.

Puerto Rico Telephone Authority (PRTA) – PRTA is governed by a five-member board comprising the President of GDB and four members that are appointed by the board of directors of GDB. PRTA is the legal entity responsible to account for the equity interest in Telecomunicaciones de Puerto Rico, Inc. for the benefit of the Employees' Retirement System of the Government of Puerto Rico and its instrumentalities (ERS). The Commonwealth provides financial support to PRTA through legislative appropriations.

Puerto Rico Tourism Company (PRTC) – PRTC is governed by a seven-member board comprising representatives of different tourist-related sectors appointed by the Governor with the consent of the Senate. At least one member must represent internal tourism and two must not be residents of the metropolitan area. Its purpose is to promote the tourism industry of Puerto Rico. The Commonwealth provides financial support to PRTC through legislative appropriations.

(Continued)

Puerto Rico Trade and Export Company (PRTEC) – PRTEC is governed by an eight-member board comprising the Secretary of Department of Economic Development and Commerce, who is the Chairman, the Executive Director of the Ports Authority, the Secretary of the Department of Agriculture, the President of EDB, the Executive Director of PRIDCO, the Legal Division Director of PRTEC, and two private citizens. PRTEC has the responsibility to promote the highest efficiency in the services provided to the commercial sector, with emphasis on small- and medium-sized enterprises while promoting the export of products and services from Puerto Rico to other countries. The Commonwealth provides financial support to PRTEC through legislative appropriations.

Right to Employment Administration (REA) – REA is governed by an administrator appointed by the Governor with the consent of the Senate. The Commonwealth provides financial support to REA through legislative appropriations and federal funds.

Special Communities Perpetual Trust (SCPT) – SCPT is governed by a board of directors composed of eleven members: the Secretary of Housing of the Commonwealth, the Secretary of the DTPW of the Commonwealth, the Coordinator for the Social and Economic Financing of the Special Communities, one major of a municipality of Puerto Rico, one community leader resident in one special community, four private citizens representing the public interest, and two public employees. All members of the board of directors are appointed by the Governor. SCPT's principal purpose is o fund development projects that address the infrastructure and housing needs of the underprivileged communities. The Commonwealth provides financial support to SCPT through legislative appropriations.

State Insurance Fund Corporation (SIFC) – SIFC is governed by a six-member board appointed by the Governor with the advice and consent of the Senate. The board comprises the Commissioner of Insurance of Puerto Rico, an officer from the Department of Labor and Human Resources of the Commonwealth, an officer from the Department of Health of the Commonwealth (DOH), a representative of the employer's interest, a representative of the employees' interest, and two members without any of these interests. One of these members is appointed by the Governor as president of the board for a period of six years. The three public officials are appointed for a period of five years, and the rest of the members for four, three, two, and one year, respectively. SIFC provides workers' compensation and disability insurance to public and private employees. The Commonwealth has access to SIFC's resources.

Complete financial statements of the discretely presented component units can be obtained directly by contacting their administrative offices:

Government Development Bank for Puerto Rico
P.O. Box 42001
San Juan, PR 00940 – 2001

Puerto Rico Aqueduct and Sewer Authority
P.O. Box 7066
San Juan, PR 00916-7066

Puerto Rico Electric Power Authority
P.O. Box 364267
San Juan, PR 00936-4267

Puerto Rico Health Insurance Administration
P.O. Box 195661
San Juan PR 00919-5661

Puerto Rico Highways and Transportation Authority
P.O. Box 42007
San Juan, PR 00940-2007

Puerto Rico Infrastructure Financing Authority
Capital Center
235 Ave. Arterial Hostos, Suite 1600
San Juan, PR 00918-1433

Puerto Rico Sales Tax Financing Corporation
P.O. Box 42001
San Juan PR 00940-2001

University of Puerto Rico
Jardin Botanico Sur 1187
Calle Flamboyan
San Juan, PR 00926-1117

Agricultural Services and Development Administration
P.O. Box 9200
San Juan, PR 00908-0202

Automobile Accidents Compensations Administration
P.O. Box 364847
San Juan, PR 00936-4847

Cardiovascular Center Corporation of Puerto Rico and the Caribbean
P.O. Box 366528
San Juan, PR 00936-6528

Caribbean Basin Projects Financing Authority
P.O. Box 42001
San Juan, PR 00940-2001

Culebra Conservation and Development Authority
P.O. Box 217
Culebra, PR 00775-0217

Economic Development Bank for Puerto Rico
P.O. Box 2134
San Juan, PR 00922-2134

Employment and Training Enterprises Corporation
P.O. Box 366505
San Juan, PR 00936-6505

Farm Insurance Corporation of Puerto Rico
P.O. Box 9200
Santurce, PR 00908

Fine Arts Center Corporation
P.O. Box 41287 – Minillas Station
San Juan, PR 00940-1287

Governing Board of the 9-1-1 Service
P.O. Box 270200
San Juan, PR 00927-0200

Institute of Puerto Rican Culture
P.O. Box 9024184
San Juan, PR 00902-4184

Institutional Trust of the National Guard of Puerto Rico
P.O. Box 9023786
San Juan, PR 00902-3786

Land Authority of Puerto Rico
P.O. Box 9745
San Juan, PR 00908-9745

National Parks Company of Puerto Rico
P.O. Box 902098
San Juan, PR 00902-2089

Puerto Rico Conservatory of Music Corporation
350 Lamar Street and Roosevelt Avenue
San Juan, PR 00918-2199

Puerto Rico Council on Higher Education
P.O. Box 19900
San Juan, PR 00910-1900

Puerto Rico Industrial Development Company
P.O. Box 362350
San Juan, PR 00936-2350

Puerto Rico Land Administration
P.O. Box 363767
San Juan, PR 00936-3767

Puerto Rico Metropolitan Bus Authority
P.O. Box 195349
San Juan, PR 00919-5349

Puerto Rico Ports Authority
P.O. Box 362829
San Juan, PR 00936-2829

Puerto Rico School of Plastic Arts
P.O. Box 9021112
San Juan, PR 00902-1112

Puerto Rico Telephone Authority
P.O. Box 42001
San Juan, PR 00940-2001

Musical Arts Corporation
P.O. Box 41227 – Minillas Station
San Juan, PR 00940-1227

Public Corporation for the Supervision and
Deposit Insurance of Puerto Rico Cooperatives
P.O. Box 195449
San Juan, PR 00919-5449

Puerto Rico Convention Center District Authority
P.O. Box 19269
San Juan, PR 00910-1269

Puerto Rico Government Investment Trust Fund
P.O. Box 42001 – Minillas Station
San Juan, PR 00940-2001

Puerto Rico Industrial, Tourist, Educational,
Medical, and Environmental Control
Facilities Financing Authority
P.O. Box 42001
San Juan, PR 00940-2001

Puerto Rico Medical Services Administration
P.O. Box 2129
San Juan, PR 00922-2129

Puerto Rico Municipal Finance Agency
P.O. Box 42001
San Juan, PR 00940

Puerto Rico Public
Broadcasting Corporation
P.O. Box 19-0909
San Juan, PR 00919-0909

Puerto Rico Solid Waste Authority
P.O. Box 40285 – Minillas Station
San Juan, PR 00940-0285

Puerto Rico Tourism Company
P.O. Box 902-3960
Old San Juan Station
San Juan, PR 00902-3960

Puerto Rico Trade and Export Company
P.O. Box 195009
San Juan, PR 00919-5009

Special Communities
Perpetual Trust
P.O. Box 42001
San Juan, PR 00940-2001

Right to Employment Administration
P.O. Box 364452
San Juan, PR 00936-4452

State Insurance Fund
Corporation
P.O. Box 365028
San Juan, PR 00936-5028

The financial statements of the discretely presented component units have a year-end of June 30, 2007, except for the Puerto Rico Telephone Authority, which has a year-end of December 31, 2006.

Fiduciary Component Units

The three employee retirement systems administer pension funds for the Commonwealth and its political subdivisions. The three systems are subject to legislative and executive controls, and the administrative expenses are subject to legislative budget controls. These component units, while meeting the definition of a component unit and are legally separate, are presented in the fund financial statements along with other fiduciary funds of the Commonwealth. They have been omitted from the government-wide financial statements.

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) – ERS is governed by a board of trustees, which is composed of the Secretary of the Treasury of the Commonwealth, who is the President, the President of GDB, the Commissioner for Municipal Affairs, the Director of the Puerto Rico Central Office of Personnel Administration, two participating employees, and one retiree, who are appointed by the Governor. The Commonwealth reports ERS as a single-employer pension plan. ERS is the administrator of a defined-benefit pension plan, which covers all regular employees of the Commonwealth and its instrumentalities and of certain municipalities and component units not covered by their own retirement systems. On September 24, 1999, an amendment to the law that created ERS was enacted with the purpose of establishing a new defined-contribution plan (System 2000) for employees hired by the government on or after January 1, 2000.

Puerto Rico Judiciary Retirement System (JRS) – JRS is governed by the same board of trustees as ERS. JRS is a single-employer defined-benefit plan, administered by ERS, which covers all individuals holding a position as Justice of the Supreme Court, Judge of the Superior Court or the District Court, or Municipal Judges of the Commonwealth.

(Continued)

Puerto Rico System of Annuities and Pensions for Teachers (TRS) – TRS is governed by a nine-member board comprising the Secretary of Education of the Commonwealth, the Secretary of the Treasury of the Commonwealth, the President of GDB, two active teachers (one of them is a representative of the teachers' organization according to Act No. 45 of February 1998), two retired teachers, one representative of the teachers' organization, and one representative of the public interest appointed by the Governor with the advice and consent of the Senate for four years. The Commonwealth reports TRS as a single-employer pension plan. TRS provides retirement benefits to all teachers of the Department of Education of the Commonwealth, all pensioned teachers, all teachers transferred to an administrative position in the Department of Education of the Commonwealth, teachers who work in the Teachers' Association of Puerto Rico, and those who practice in private institutions accredited by the Department of Education of the Commonwealth. TRS provides retirement, death, and disability benefits.

Complete financial statements of these component units can be obtained directly by contacting their respective administrative offices at:

Employees' Retirement System of the
Government of Puerto Rico and its
Instrumentalities
P.O. Box 42003 – Minillas Station
Santurce, PR 00940

Puerto Rico Judiciary
Retirement System
P.O. Box 42003 – Minillas Station
Santurce, PR 00940

Puerto Rico System of Annuities and Pensions for
Teachers
P.O. Box 191879
San Juan, PR 00919-1879

(c) Government-wide Financial Statements

The government-wide financial statements (the statement of net assets and the statement of activities) report information of all of the nonfiduciary activities of the Commonwealth and its component units. For the most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from the legally separate component units for which the primary government is financially accountable. The statement of net assets presents the reporting entities' nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- ***Invested in Capital Assets, Net of Related Debt*** – These consist of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

- ***Restricted Net Assets*** – These result when constraints placed on net assets' use on either externally imposed by creditors, grantors, contributors, and the like or imposed by law through constitutional provisions or enabling legislation.
- ***Unrestricted Net Assets*** – These consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, generally, it is the Commonwealth's policy to use restricted resources first, then the unrestricted resources as they are needed.

The statement of activities demonstrates the degree to which the direct expenses of a given function, segment, or component unit are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function, segment, or component unit. Program revenue includes charges to customers who purchase, use, or directly benefit from goods or services provided by a given function, segment, or component unit. Program revenue also includes grants and contributions that are restricted to meeting the operational or capital requirements of a particular function, segment, or component unit. Taxes and other items not properly included among program revenue are reported instead as general revenue. Resources that are dedicated internally are reported as general revenue rather than as program revenue. The Commonwealth does not allocate general government (indirect) expenses to other functions.

(d) Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide Financial Statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified-accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. Principal revenue sources considered susceptible to accrual include tax revenue, net of estimated overpayments (refunds) and amounts considered not collectible, which are recorded as taxpayers earn income (income taxes), as sales are made (consumption, sales and use taxes) and as cash is received (miscellaneous taxes). For this purpose, the Commonwealth considers income tax revenue to be available if collected within 120 days after the end of the current fiscal year-end and consumption sales and are tax if collected within 30 days after the end of the current fiscal year. In applying the susceptible to accrual concept to federal grants, there are essentially two types of revenue. For the majority of grants, moneys must be expended by the Commonwealth on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employees' vested annual vacation and sick leave are recorded as expenditures when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2007 has been reported only in the government-wide financial statements.
- Interest and principal on general long-term obligations are recorded when due, except for interest and principal due on July 1 of the following fiscal year, if resources are available for its payment as of June 30.
- Executory purchase orders and contracts are recorded as a reservation of fund balance.
- Debt service expenditures, federal funds' cost disallowances, other long-term obligations, and amounts subject to judgments under litigation are recorded only when payment is due.

Proprietary Funds, Fiduciary Funds, and Discretely Presented Component Units Financial Statements – The financial statements of the proprietary funds, fiduciary funds, and discretely presented component units are reported using the economic measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

Each enterprise fund has the option under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless these conflict with a GASB pronouncement. The primary government's major enterprise funds have elected not to apply FASB pronouncements issued after November 30, 1989 and two nonmajor enterprise funds elected to adopt the FASB's pronouncements issued after November 30, 1989. Also, certain discretely presented component units have disclosed their election in their separately issued financial statements. The component units follow U.S. GAAP as issued by GASB and FASB as applicable to each component unit based on the nature of their operations. In addition, the Puerto Rico Government Investment Trust Fund adopted GASB Statement No. 31; *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*; however, such financial statements are not included in the accompanying basic financial statements because the primary government and each component unit's investor already present their corresponding share of the assets of the PRGITF as cash or investments.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses. The major operating revenue of the Commonwealth enterprise funds is as follows:

- Unemployment Insurance Fund – Amounts requisitioned for the Puerto Rico Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits and charges made to individual employers.
- Lotteries Fund – Amounts collected from the sale of traditional lottery tickets and electronic lotto games.

(e) Fund Accounting

The Commonwealth reports its financial position and results of operations in funds, which are considered separate accounting entities, and discrete presentations of those component units, which are not required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. Major funds are determined using a predefined percentage of the assets, liabilities, revenue, or expenditures/expenses of either the fund category or the governmental and enterprise funds combined. The nonmajor funds are combined in a single column in the fund financial statements. The Commonwealth reports the following major funds:

Governmental Funds

General Fund – The general fund is the primary operating fund of the Commonwealth. It is used to account for all financial transactions, except those required to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, and education.

Debt Service Fund – The debt service fund accounts for the accumulation of resources predominantly for, and the payment of, general long-term bonds' principal, interest, and related costs other than bonds payable from the operations of proprietary fund types, pension trust funds, and discretely presented component units. Long-term debt and interest due on July 1 of the following fiscal year are accounted for as a fund liability if resources are available as of June 30 for its payment.

Public Buildings Authority's Capital Projects Fund – The Public Buildings Authority's capital projects fund is used to account for the financial resources used for the acquisition or construction of major capital facilities not financed by proprietary fund types, pension trust funds, and discretely presented component units.

The Children's Trust Special Revenue Fund – The Children's Trust special revenue fund is used to account for the moneys received by the Commonwealth from a global settlement agreement dated November 23, 1998 between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The financial resources received by this fund are used to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico.

Proprietary Funds

These funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to the general public.

Unemployment Insurance Fund – This fund accounts for amounts requisitioned for the Puerto Rico Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits and charges made to individual employers.

Lotteries Fund – This fund accounts for the assets and operations of two lottery systems administered by the Commonwealth.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity, or as an agent for individuals, private organizations, and other governmental units. The following are the Commonwealth's fiduciary funds:

Pension Trust Funds – These are used to account for the assets, liabilities, and net assets available for pension benefits held in trust for the public employees' retirement systems.

Agency Funds – These are custodial in nature (assets equal liabilities) and do not involve measurement of the results of operations.

Discretely Presented Component Units

Discrete presentation of component units is used to present the financial information of entities that do not qualify to be blended, in accordance with GASB No. 14 as amended by GASB No. 39, with the funds of the primary government. The component units column in the government-wide financial statements is used to report the financial activities of the Commonwealth's discretely presented component units. The financial statements of these component units are presented following the accrual basis of accounting. Under the accrual basis, revenue is recognized when earned and expenses are recorded as liabilities when incurred, without regard to receipt or payment of cash.

(f) Statutory (Budgetary) Accounting

The Commonwealth's budget is adopted in accordance with a statutory basis of accounting, which is not in accordance with GAAP. Revenue is generally recognized when cash is received, net of tax refunds claimed by taxpayers as of year-end. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenue. Expenditures are generally recorded when the related expenditure is incurred or encumbered. Encumbrances generally lapse the year following the end of the fiscal year when the encumbrance was established, as established by Act No. 123 of August 17, 2001, which amended the then-existing appropriations and encumbrances lapsing provisions of Act No. 230 of July 23, 1974. Unencumbered appropriations lapse at year-end. Amounts required for settling claims and judgments against the Commonwealth and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment.

Under the statutory basis of accounting, the Commonwealth uses encumbrance accounting to record the full amount of purchase orders, contracts, and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control.

The statement of revenue and expenditures – budget and actual – budget basis – general fund only presents the information for the general fund for which there is a legally adopted budget, as required by GAAP. See note 3 for a reconciliation of the statement of revenue and expenditures – budget and actual – budget basis – general fund with the statement of revenue, expenditures, and changes in fund balance (deficit) for the general fund. The special revenue funds do not have a legally mandated budget.

(g) Cash and Short-Term Investments

The Commonwealth follows the practice of pooling cash. The balance in the pooled cash accounts is available to meet current operating requirements, and any excess is invested in various interest-bearing accounts with GDB and with the PRGITF. Cash and cash equivalents include investments with original maturities of 90 days or less from the date of acquisition.

The Commissioner of Financial Institutions requires that private financial institutions deposit collateral securities to secure the deposits of the Commonwealth and all other governmental entities in each of these institutions. The amount of collateral securities to be pledged for the security of public deposits shall be established by the rules and regulations promulgated by the Commissioner of Financial Institutions.

The Puerto Rico Unemployment Insurance Trust Fund is maintained to account for the collection of unemployment insurance contributions from employers and the payment of unemployment benefits to eligible claimants. As required by federal law, all resources not necessary for current benefit payments are placed on deposit with the U.S. Treasury. Interest earned over such deposit is retained in the fund.

Cash and short-term investments and cash equivalents of the component units are maintained in separate bank accounts, from those of the primary government, in their own names.

(Continued)

(h) *Securities Purchased under Agreements to Resell*

Certain component units of the Commonwealth enter into purchases of securities with simultaneous agreements to resell. The securities underlying these agreements mainly consist of U.S. government obligations, mortgage-backed securities, and interest-bearing deposits with other banks.

(i) *Securities Lending Transactions*

Certain component units of the Commonwealth enter into securities lending transactions in which governmental entities (lenders) transfer their securities to broker-dealers and other entities (borrowers) for collateral with a simultaneous agreement to return the collateral for the same securities in the future. Securities received as collateral are generally reflected as investments with a corresponding liability resulting from the obligation to return such collateral.

(j) *Investments*

Investments include U.S. government and agencies' obligations, mortgage-backed securities, repurchase agreements, commercial paper, local government obligations, investment contracts, and corporate debt and equity obligations. Investment securities, including investments in limited partnerships, are presented at fair value, except for money market investments and participating investment contracts with a remaining maturity at the time of purchase of one year or less and nonparticipating investment contracts, which are presented at cost. Changes in the fair value of investments are presented as investment earnings in the statement of activities, the statement of revenue, expenditures, and changes in balance – governmental funds, and the statement of revenue, expenses, and changes in fund net assets – proprietary funds. Fair value is determined based on quoted market prices. When securities are not listed on national exchanges, quotations are obtained from brokerage firms.

The PRGITF is considered a 2a7-like external investment pool and, as such, reports its investments at amortized cost.

The reverse repurchase agreements reported by certain discretely presented component units are authorized transactions under their respective enabling legislation and authorized by GDB.

(k) *Receivables*

Tax receivables in the general fund include predominantly amounts owed by taxpayers for individual and corporate income taxes, net of estimated uncollectible amounts. Income tax receivables are recognized as revenue when they become measurable and available based on actual collections during the 120 days following the fiscal year-end related to tax returns due before year-end. Tax receivables also include amounts owed by taxpayers on income earned in periods prior to June 30, 2007, estimated to be collectible but not currently available, and thus are reported as deferred revenue in the general fund. Unemployment, disability, and driver's insurance receivables in the enterprise funds are stated net of estimated allowances for uncollectible accounts. During the fiscal year 2007 the Commonwealth started imposing a general sales and use tax. The sales and use tax receivable is recognized as revenue when it becomes measurable and available based on actual collections during the 30 days following the fiscal year-end related to sales and use tax returns due before year-end.

(Continued)

Accounts receivable are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables primarily represent amounts owed to the Commonwealth for reimbursement of expenditures incurred pursuant to federally funded programs. Intergovernmental receivables also include taxes that the Municipal Revenue Collection Center (CRIM, as per its Spanish acronym), a municipal corporation, is required to remit to the Commonwealth to be used by the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth. The amount to be remitted is based on the special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation, which is levied by the CRIM.

The accounts receivable from nongovernmental customers of the component units are net of estimated uncollectible amounts. These receivables arise primarily from service charges to users. Accounts receivable from the primary government and other component units that arise from service charges do not have allowances for uncollectible accounts, as these are deemed fully collectible.

Loans of the general fund represent predominantly amounts owed by public corporations and municipalities for public insurance and rent paid by the general fund on their behalf.

The loans of the pension trust funds do not have allowances for uncollectible amounts since such loans are secured by mortgage deeds, plan members' contributions, and any unrestricted amounts remaining in escrow. Loans of the component units consist predominantly of loans to the primary government, other component units, and municipalities, and do not have allowances for uncollectible accounts as those are deemed fully collectible. The remaining loans of the component units are to small and medium businesses, agricultural, and low-income housing loans from nongovernmental customers, and are presented net of estimated losses on such portfolios.

(l) Inventories

Generally, inventories are valued at cost and predominantly on the first-in, first-out basis. Governmental fund inventories are recorded as expenditures when purchased rather than capitalized as an asset. Only significant amounts of inventory at the end of the year are capitalized in the governmental funds. However, inventories are always capitalized in the statement of net assets of governmental activities.

(m) Restricted Assets

Funds set aside for the payment and guarantee of notes and interest payable and for other specified purposes are classified as restricted assets since their use is limited for this purpose by applicable agreements or required by law. Restricted assets in the proprietary funds mainly include amounts set aside for the payment of insurance benefits.

(n) Real Estate Held for Sale

Real estate held for sale are carried at the lower of fair value or cost, which is established by a third-party professional assessment or based upon an appraisal, minus estimated costs to sell. Subsequent declines in the value of real estate available for sale are charged to expenditure/expense.

(o) Capital Assets

Capital assets, which include land, buildings, building improvements, equipment, vehicles, construction in process, and infrastructure assets, are reported in the applicable governmental, business-type activities, and component unit columns in the government-wide financial statements. The Commonwealth's primary government defines capital assets as assets that have an initial, individual cost of $25,000 or more at the date of acquisition and have a useful life of five or more years. Capital assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available.

The method to deflate the current cost of the same or a similar asset using an approximate price index was used to estimate the historical cost of certain land, buildings, and building improvements, because invoices and similar documentation were no longer available in certain instances. Donated capital assets are recorded at fair market value at the time of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest costs are capitalized during the construction period only for business-type activities and most component units. The costs of normal maintenance and repairs that do not add value to the assets or materially extend asset lives are not capitalized.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds and component units' financial statements.

Capital assets of the primary government are depreciated on the straight-line method over the assets' estimated useful life. There is no depreciation recorded for land and construction in progress. The estimated useful life of capital assets is as follows:

	Years
Buildings and building improvements	20 – 50
Equipment, furniture, fixtures, and vehicles	5 – 15
Infrastructure	50

The capital assets of the component units are recorded in accordance with the applicable standards of the component units and under their own individual capitalization thresholds. Depreciation has been recorded when required by these standards based on the types of assets, use and estimated useful lives of the respective assets, and on the nature of each of the component unit's operations.

The estimated useful lives of capital assets reported by the component units are as follows:

	Years
Buildings and building improvements	3 – 50
Equipment, furniture, fixtures, and vehicles	3 – 20
Infrastructure	10 – 50

The Commonwealth follows the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries—an amendment to GASB Statement No. 34*. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

(p) Tax Refunds Payable

During the calendar year, the Commonwealth collects individual income taxes through withholdings and payments from taxpayers. At June 30, the Commonwealth estimates the amount owed to taxpayers for overpayments during the first half of the calendar year. These estimated amounts and the actual tax refunds claimed for prior years but not paid at year-end are recorded as tax refunds payable and as a reduction of tax revenue.

(q) Deferred Revenue

Deferred revenue at the governmental fund level arises when potential revenue does not meet either the "measurable" or the "available" criteria for revenue recognition in the current period. Deferred revenue also arises when resources are received before the Commonwealth has a legal claim to them, as when grant moneys are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Commonwealth has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet, and the revenue is recognized. Deferred revenue at the government-wide and proprietary fund levels arises only when the Commonwealth receives resources before it has a legal claim to them.

(r) Long-Term Debt

The liabilities reported in the government-wide financial statements include Commonwealth's general obligation bonds and long-term notes, obligations under lease/purchase agreements, and long-term liabilities including vacation, sick leave, long-term liabilities to other governmental entities, net pension obligation, legal claims, and noncurrent federal fund cost disallowances related to expenditures of federal grants. Long-term obligations financed by proprietary fund types and component units are recorded as liabilities in those funds and in the discretely presented component units column.

Premiums, discounts, and issuance costs – in the government-wide financial statements, long-term debt, and other long-term obligations – are presented in the columns for governmental and business-type activities. The same is presented in the proprietary fund financial statements. Bond and note premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the debt. Bonds and notes payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges in other assets and are amortized over the term of the related debt. In the governmental fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

(s) Reservations of Fund Balance – Governmental Funds

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. Reserves for encumbrances, debt service, and other specific purposes are examples of the latter.

(t) Accounting for Pension Costs

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*, the Commonwealth's financial reporting entity is considered to be a sponsor of three single-employer defined-benefit pension plans: ERS, JRS, and the TRS. This is because substantially all the participants in the three pension trust funds are part of the financial reporting entity of the Commonwealth. For the purpose of the basic financial statements, and as disclosed in note 19, the Commonwealth's annual pension cost, measured on the accrual basis of accounting, for the year ended June 30, 2007 amounted to approximately $999 million. However, the amount recognized as pension expenditure in the governmental funds was recorded under the modified accrual basis, and amounted to approximately $641 million. The excess of the annual required contribution over the statutorily required contributions increased the net pension obligation at June 30, 2007 to approximately $5.1 billion. This amount is presented in the statement of net assets of the governmental activities as of June 30, 2007.

For purposes of the stand-alone financial statements of each of the blended and discretely presented component units, the entities accounted for pension costs from the standpoint of a participant in a multiple-employer cost sharing plan. Accordingly, pension costs recognized are equal to the statutorily or contractually required contributions, with a liability recorded for any unpaid required contributions. The basis of accounting used by the component units was either modified accrual basis or accrual basis, depending upon individual fund structure and type of entity. Most component units did not have pension-related assets or liabilities at transition because they have contributed the statutorily required contributions.

(u) Postemployment Benefits

In addition to the pension benefits described in note 19, the Commonwealth provides postemployment healthcare benefits, Summer bonus, and a Christmas bonus for its retired employees in accordance with local law. Substantially, all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Commonwealth. Healthcare benefits are provided through insurance companies whose premiums are paid by the retiree with the Commonwealth providing a matching share of not more than $100 per month for each retiree.

During the year ended June 30, 2007, the cost of providing healthcare benefits amounted to approximately $148 million for approximately 123,594 retirees. The Christmas bonus paid to these retired employees during the year ended June 30, 2007 was $400 per retiree and the total amount was approximately $49 million. These benefits are recorded as expenditures when paid in the general fund. The summer bonus paid to these retired employees during the year ended June 30, 2007 was $100 per retiree and the total amount was approximately $12 million. These benefits are recorded as an expense in the pension trust fund. During the year ended June 30, 2007, the Commonwealth implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43, which establishes uniform financial reporting standards for other postemployment benefits (OPEB) plans. This statement applies for OPEB trust funds of a plan sponsor or governmental unit employer as well as for stand-alone reports of OPEB plans. For multiple-employer OPEB plans, GASB Statement No. 43 is effective one year prior to the effective date of the related financial statements for the largest participating employer in the plan. The adoption of this statement did not have a significant impact in the accompanying basic financial statements.

(v) Compensated Absences

The vacation policy of the Commonwealth generally provides for the accumulation of 2.5 days per month, except for the teachers who accrue 4 days per month. Vacation time accumulated is fully vested to the employees from the first day of work up to a maximum of 60 days. Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated unpaid leave at the current rate, if the employee has at least 10 years of service with the Commonwealth. Accrued compensated absences of the primary government at June 30, 2007 amounting to approximately $1.8 billion is presented in the statement of net assets. Compensated absence accumulation policies for the blended component units and discretely presented component units vary from entity to entity based on negotiated agreements and other factors agreed upon between the management of these entities and their employees.

The Public Service Personnel Law requires certain component units and the primary government of the Commonwealth to annually pay the employees the accumulated vacation and sick leave earned in excess of the limits mentioned above.

(w) Interfund and Intraentity Transactions

The Commonwealth has the following types of transactions among funds:

Interfund Transfer – Legally required transfers that are reported when incurred as transfer-in by the recipient fund and as transfer-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivable and payable are considered internal balances and activities that have been eliminated in the government-wide financial statements.

Intraentity Transactions – There are two types of intraentity transactions. First, are resource flows between the primary government and its component units and among the component units. These resource flows and related outstanding balances are reported as if they were external transactions. However, resource flows between the primary government and blended component units are classified as interfund transactions, as described above. Second, are intraentity balances between the primary government funds and discretely presented component units that are tantamount to long-term debt financing. The primary government's liability is reported in the statement of net assets, the proceeds in the primary government's funds, and the asset in the discretely presented component units' statement of net assets.

(x) Lottery Revenue and Prizes

The revenue, expenses, and prizes awarded by the Lottery of Puerto Rico and the Additional Lottery System, reported within the lotteries enterprise fund, are recognized as drawings are held. Moneys collected prior to June 30 for tickets related to drawings to be conducted subsequent to June 30 are reported as deferred revenue. Unpaid prizes awarded as of June 30 are reported as a fund liability. Unclaimed prizes expire after six months and are transferred to the general fund.

(y) Risk Management

The Commonwealth purchases commercial insurance covering casualty, theft, tort claims, and other losses for the primary government, most component units, and the municipalities. The Commonwealth is reimbursed for premium payments made on behalf of the component units and the municipalities. The current insurance policies have not been canceled or terminated. For workers' compensation, the Commonwealth has a discretely presented component unit, the SIFC, which provides workers' compensation to both public and private employees. In the past three years, the Commonwealth has not settled claims that exceed insurance coverage.

Certain component units combine commercial insurance with internal self-insurance funds covering specific risks related to their specialized operations.

(z) GASB Technical Bulletin No. 2004-1

The Trust follows GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issue* (the TB), which provides accounting guidance for entities created to obtain the rights to all or a portion of future tobacco settlement resources and for the governments that create such entities.

The TB indicates that the entity created to obtain the rights, which is called the Tobacco Settlement Authority (TSA), should be considered a component unit of the government that created it and the component unit should be blended. The TB also states that the government receiving the payments from the tobacco companies under the agreement, which are called settling governments, should recognize a receivable and revenue for tobacco settlement resources (TSRs) when an event occurs. The event that results in the recognition of an asset and revenue by the settling government is the domestic shipment of cigarettes. The TB indicates that accruals should be made by the settling government and TSAs for estimated shipments from January 1 to their respective fiscal year-ends, since the annual payments are based on a calendar year. However, under the modified accrual basis of accounting at the fund level, revenue should be recognized only to the extent that resources are available.

(aa) Reclassifications

Certain reclassifications have been made to the information presented in the separately issued financial statements of certain blended component units and agencies included within the special revenue, debt service, capital projects, proprietary funds, and discretely presented component units to conform to the accounting classifications used by the Commonwealth in the basic financial statements.

(bb) Use of Estimates

The preparation of the basic financial statements in conformity with GAAP 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 basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(cc) 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 Postemployment Benefits Other Than Pensions*. This statement establishes standards for the measurement, recognition, and display of OPEB, expense/expenditures and related liabilities (assets), notes disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of the state and local governmental employers. This Statement is effective for periods beginning after December 15, 2006.

- GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. This statement establishes criteria that governments will use to ascertain whether the proceeds received from the sale and pledge of receivables and future revenues should be reported as revenue or as a liability. Also, this Statement includes a provision that governments should not revalue assets that are transferred between financial reporting entity components. This Statement is effective for periods beginning after December 15, 2006.

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement is effective for periods beginning after December 15, 2007.

- GASB Statement No. 50, *Pension Disclosures*. This statement amends GASB Statements No. 25 and 27 to require defined benefit pension plans, and sole and agent employers present the following information in their financial statements: (1) disclose the funded status of the plan as the most recent actuarial valuation date; (2) disclose the funded status of the plan, and a schedule of funding progress as required supplementary information

(RSI), using the entry age actuarial cost method (aggregate actuarial cost method used); (3) include a reference linking the funded status disclosure in the notes to financial statements to the required schedule of funding progress in RSI; (4) if actuarial assumptions are different for successive years, disclose the initial and ultimate rates. This Statement is effective for periods beginning after June 15, 2007.

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. This Statement is effective for periods beginning after June 15, 2009.

- GASB Statement No. 52, *Land and Other Real Estates Held as Investment by Endowments.* This statement requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the method and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported as fair value. This Statement is effective for periods beginning after June 15, 2008.

- GASB Technical Bulletin No. 2004-2, *Recognition of Pensions and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers.* As it relates to pension transactions, this technical bulletin became effective for financial statements for periods ended after December 15, 2004. As it relates to OPEB transactions, it is effective for financial statements for periods beginning after December 15, 2006. The effect of this technical bulletin on the accompanying basic financial statements was not considered material as it relates to pension transactions.

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

(2) Component Units

The Commonwealth follows the provisions of GASB Statement No. 14, as amended by GASB Statement No. 39. The basic financial statements of the Commonwealth include the financial statements of the following component units that were audited by other auditors:

Blended component units:

Public Buildings Authority
Puerto Rico Maritime Shipping Authority
The Children's Trust

Discretely presented component units:

Agricultural Services and Development Administration
Automobile Accidents Compensations Administration
Cardiovascular Center Corporation of Puerto Rico and the Caribbean
Caribbean Basin Projects Financing Authority
Culebra Conservation and Development Authority

Employment and Training Enterprises Corporation
Farm Insurance Corporation of Puerto Rico
Fine Arts Center Corporation
Governing Board of the 9-1-1 Service
Government Development Bank for Puerto Rico
Institute of Puerto Rican Culture
Institutional Trust of the National Guard of Puerto Rico
Land Authority of Puerto Rico
Musical Arts Corporation
National Parks Company of Puerto Rico
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives
Puerto Rico Conservatory of Music Corporation
Puerto Rico Convention Center District Authority
Puerto Rico Council on Higher Education
Puerto Rico Electric Power Authority
Puerto Rico Government Investment Trust Fund
Puerto Rico Health Insurance Administration
Puerto Rico Highways and Transportation Authority
Puerto Rico Industrial Development Company
Puerto Rico Industrial, Tourist, Educational, Medical, Environmental
Control Facilities Financing Authority
Puerto Rico Infrastructure Financing Authority
Puerto Rico Land Administration
Puerto Rico Medical Services Administration
Puerto Rico Metropolitan Bus Authority
Puerto Rico Municipal Finance Agency
Puerto Rico Ports Authority
Puerto Rico Public Broadcasting Corporation
Puerto Rico School of Plastic Arts
Puerto Rico Solid Waste Authority
Puerto Rico Telephone Authority
Puerto Rico Tourism Company
Puerto Rico Trade and Export Company
Right to Employment Administration
Special Communities Perpetual Trust
State Insurance Fund Corporation
University of Puerto Rico

Fiduciary component units:

Employees' Retirement System of the Government
of Puerto Rico and its Instrumentalities
Puerto Rico Judiciary Retirement System
Puerto Rico System of Annuities and Pension for Teachers

(3) Stewardship, Compliance, and Accountability

(a) Budgetary Control

The Governor is constitutionally required to submit to the Legislature an annual balanced budget of the Commonwealth for the ensuing fiscal year. The annual budget is prepared by the Commonwealth's OMB and takes into consideration the advice provided by the Puerto Rico Planning Board (annual economic growth forecasts and four-year capital improvements plan), the Department of the Treasury of the Commonwealth (revenue estimates, accounting records, and the comprehensive annual financial report), GDB (fiscal agent), and other governmental offices and agencies. Section 7 of Article VI of the Constitution of Puerto Rico provides that "The appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for the said fiscal year, unless the imposition of taxes sufficient to cover the said appropriations is provided by law."

The annual budget, which is developed utilizing elements of program budgeting, includes an estimate of revenue and other resources for the ensuing fiscal year under: (1) laws existing at the time the budget is submitted; and (2) legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year capital improvements plan adopted by the Puerto Rico Planning Board.

The Legislature may amend the budget submitted by the Governor but may not increase any items so as to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. Upon passage by the Legislature, the budget is referred to the Governor who may decrease or eliminate any line item but may not increase or insert any new line item in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Legislature and the Governor, is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This permits the Commonwealth to continue making payments for its operating and other expenses until the new budget is approved. The appropriated annual budget for fiscal year 2007 amounted to approximately $5.6 billion. The Legislature also made several special budgetary appropriations to the general fund throughout the year, which amounted to approximately $3.8 billion.

The OMB has authority to amend the budget within a department, agency, or government unit without legislative approval.

For budgetary purposes, encumbrance accounting is used. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of budgetary appropriations within GAAP fund balances and do not constitute expenditures or liabilities on a GAAP basis because the commitments will be honored during the subsequent year. The unencumbered balance of any appropriation of the general fund at the end of the fiscal year lapses immediately. Appropriations, other than in the general fund, are continuing accounts for which the

(Continued)

Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

During any fiscal year in which the resources available to the Commonwealth are insufficient to cover the appropriations approved for such year, the Governor may take administrative measures to reduce expenses and submit to both houses of the Legislature a detailed report of any adjustment necessary to balance the budget, or make recommendations to the Legislature for new taxes or authorize borrowings under provisions of existing legislation or take any other necessary action to meet the estimated deficiency. Any such proposed adjustments shall give effect to the " priority norms" established by law for the disbursement of public funds in the following order of priority; first, the payment of the interest on and amortization requirements for public debt (Commonwealth general obligations and guaranteed debt for which the Commonwealth's guarantee has been exercised); second, the fulfillment of obligations arising out of legally binding contracts, court decisions on eminent domain, and other unavoidable obligations to protect the name, credit and good faith of the Commonwealth; third, current expenditures in the areas of health, protection of persons and property, education, welfare and retirement systems; and fourth, all other purpose.

In addition, the Legislature may direct that certain revenue be retained and made available for spending within a specific appropriation account. Generally, expenditures may not exceed the level of spending authorized for an individual department. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated. Appropriations are enacted for certain departments, agencies, and government units included in the balance sheet of the general fund. For these funds, a statement of revenue and expenditures – budget and actual budget basis – general fund is included. Appropriations for capital projects are made for each bond issue and the authorization continues for the expected construction period.

The OMB has the responsibility to ensure that budgetary spending control is maintained on an individual department basis. OMB may transfer part or all of any unencumbered balance within a department to another department subject to legislative approval. Budgetary control is exercised through the Puerto Rico Integrated Financial Accounting System (PRIFAS). PRIFAS ensures that encumbrances or expenditures are not processed if they exceed the department's total available spending authorization, which is considered its budget. The legal level of budgetary control is at the individual department level for general fund expenditures, principal and interest due for the year for the debt service fund, and by bond authorization for capital expenditures.

(Continued)

(b) Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity, timing, and basis differences in the excess (deficiency) of revenue and other financing sources over expenditures and other financing uses for the year ended June 30, 2007 is presented below for the general fund (expressed in thousands):

Excess of expenditures and other financing uses over revenue and other financing sources – budget basis	$	(504,864)
Entity differences:		
Excess (deficiency) of revenue and other financing sources over expenditures and other financing uses for:		
Nonbudgeted funds		705,449
Inclusion of agencies with independent treasuries		(97,287)
Timing differences:		
Adjustment for encumbrances		73,908
Current year expenditure against prior year encumbrances		(39,370)
Basis of accounting differences:		
Net increase in taxes receivable (net of tax funds)		66,039
Net increase in other receivables		(60,549)
Net decrease in deferred revenue		(270,729)
Excess of expenditures and other financing uses over revenue and other financing sources – GAAP basis	$	(127,403)

The Commonwealth's original budgeted expenditures (including transfers) for fiscal year 2007 of $9.488 billion exceeded projected revenues of $9.163 billion by approximately $325 million. The Commonwealth expected to cover this budget deficit through the implementation of additional expenditure reducing measures, a possible increase in tax revenues resulting from the reduction of the uncertainty surrounding the government's fiscal crisis, and cash management mechanisms. The possible increase in tax revenues was tempered by the adverse economic impact resulting from increases in the price of oil and the implementation of the sales and use tax.

(c) Deficit Net Assets

The following activities, funds, and discretely presented component units reflect deficit fund balance/net assets at June 30, 2007 (expressed in thousands):

Primary government:		
Governmental activities	$	18,438,894
General fund		511,158
PBA capital projects fund		34,222
Enterprise fund – lotteries		153,144

Component units:		
Puerto Rico and Sales Tax Financing Corporation	$	175,190
Land Authority of Puerto Rico		109,521
Agricultural Services and Development Administration		106,881
Puerto Rico Medical Services Administration		58,971
Cardiovascular Center Corporation of Puerto Rico and the Caribbean		37,896
Employment and Training Enterprises Corporation		7,066
Puerto Rico Tourism Company		3,511
Right to Employment Administration		2,121
Musical Arts Corporation		1,788

The Commonwealth's governmental activities show a deficit of approximately $18.4 billion, mostly attributed to long-term obligations amounting to approximately $28 billion, which are recognized in the statement of net assets. On the other hand, the discretely presented component units report net assets of approximately $13.2 billion. This inverse relationship between the governmental activities and component units' net assets reveal the operational structure of the Commonwealth where the primary government issues debt, the proceeds of which are predominantly transferred to the component units and to other governments as well, that are not presented in these basic financial statements, to finance their capital projects and other operational needs. The Commonwealth includes within the annual budgetary appropriation process the necessary funds to cover the annual debt service requirements of the aforementioned debt, most of which are the result of Act No. 164 of December 17, 2001, described in note 14(d). Also, as part of the fiscal reform referred to below, certain component units will be subject to reductions in future legislative appropriations provided by the primary government, requiring the affected component units to increase their revenue base and fee structure currently being charged to the general public.

In an effort to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Executive Branch and the Legislature enacted and the Governor signed legislation providing for tax reform and fiscal reforms. The tax reform legislation is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based sales and use tax further as explained below. The fiscal reform legislation is aimed at limiting expenditures in relation to past spending rates and stabilizing expenditure growth at a level below that of recurring revenues.

On July 4, 2006, the Legislature approved Act No. 117 (Act 117), which amended the Puerto Rico Internal Revenue Code of 1994 (the PR Code), to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the Central Government Sales Tax). Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5% (the Municipal Sales Tax and, together with the Central Government Sales Tax, the Sales Tax). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods), and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets. Act 117 repealed the 5.0% general excise tax imposed on imported goods and on goods manufactured in Puerto Rico. Certain items, such as fuel, crude oil, and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items and will not be subject to the Sales Tax. The effective date of the repeal of the 5.0% general excise tax was October 17, 2006, pursuant to Act 229.

The Sales Tax became effective on November 15, 2006. Municipalities, however, were authorized to implement the Municipal Sales Tax starting on July 1, 2006, and some did so. The revenues derived from the Sales Tax are distributed as follows: (i) municipal governments will retain 1.5% of the Sales Tax, (ii) the FIA Fund, created by Act No. 91 of May 13, 2006, will receive 1.0% of the Sales Tax, and (iii) the general fund receives 4.5% of the Sales Tax. The revenues to be generated by the Sales Tax will be partly offset by the partial elimination of the 5.0% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provided for special income tax rates with respect to certain transactions occurred on and between July 1, 2006 and December 31, 2006. These special tax rates applied to eligible dividends declared by domestic corporations or partnerships and "built-in" gains associated with capital assets held for periods in excess of six months, as well as certain withdrawals from retirement accounts. These special tax rates were only available for transactions in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. In the case of resident corporations and partnerships, these special tax rates applied only to real property located in Puerto Rico.

The Additional Lottery System (electronic Lotto Games) activities show a deficit of approximately $153 million, mostly attributed to a payment amounting to $200 million made in 2004 to the Commonwealth. This transaction was authorized pursuant to Act No. 171, dated July 29, 2004, which among other things authorized the Secretary of the Treasury of the Commonwealth to provide funding for the payment of lotto prize annuities upon depletion of other resources available at the Additional Lottery System. It is the opinion of the additional lottery management that the deficiency is not an indication of financial difficulties for the payment of long-term lotto prizes because funds will be provided from either the Additional Lottery System or from financial assistance provided by the Commonwealth.

(4) Changes in Reporting Entity and Restatement

The following table illustrates the change to net assets at the beginning of the year as previously reported in the governmental activities' statement of net assets and to fund balances at the beginning of the year as reported in the statement of revenue, expenditures, and changes in fund balances – governmental funds. The changes resulted from the effect of a net understatement in capital assets amounting to $14.7 million. The beginning balances have been restated as follows (expressed in thousands):

		Net assets – governmental activities
Beginning balance, as previously reported	$	(17,209,563)
Noncapitalization of capital assets		14,680
Beginning balance, as restated	$	(17,194,883)

The following table summarizes changes to net assets at the beginning of the year as previously reported in the statement of net assets by certain discretely presented component units. The changes resulted primarily from exclusions of nonmajor component units in the current year's presentation, and restatements to correct errors in the prior year's financial statements of certain component units (expressed in thousands):

Beginning net assets, as previously reported	$	13,084,624
Restatements of nonmajor component units audited by other auditors		(21,514)
Nonmajor component unit audited by other auditors excluded in fiscal year 2006, but included in fiscal year 2007		81,080
Beginning net assets, as restated	$	13,144,190

All of the above restatements arise from component units that were audited by other auditors (note 2).

(5) Puerto Rico Government Investment Trust Fund (PRGITF)

PRGITF was created by Act No. 176, of August 11, 1995, and began operations on December 4, 1995. PRGITF is a no-load diversified collective investment trust administered by GDB that was created for the purpose of providing eligible governmental investors of Puerto Rico with a convenient and economical way to invest in a professionally managed money market portfolio. PRGITF is not an investment company or a mutual fund and is not subject to regulation or registration under the investment company Act of 1940. Units issued by PRGITF are not subject to regulation or registration under the Securities and Exchange Act of 1933, as amended, because the units are issued by a government entity. The deposits on hand and the investments purchased are not collateralized, secured, or guaranteed by the Commonwealth or any of its agencies, instrumentalities, or political subdivisions.

PRGITF is considered a 2a7-like external investment pool, and as such, reports its investment at amortized cost.

The investment securities on hand at June 30, 2007 consisted of certificates of deposit, bank notes, corporate obligations, commercial paper, and U.S. government and agencies obligations, all of which may be considered highly liquid. However, the participants' investments are subject to the ability of PRGITF to receive payment from the securities' issuer when due. The liquidity of certain investments and changes in interest rates may affect PRGITF's yield and the fair value of its investments.

The dollar amount of the deposits on hand at June 30, 2007 at $1.00 per unit of participation, was reported in the individual financial statements of each of the participants, and combined in the basic financial statements as follows (expressed in thousands):

		Balance outstanding	Percentage of total
Primary government:			
Commonwealth	$	298,461	77.02%
The Children's Trust		48,972	12.64
Public Buildings Authority		82	0.02
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities		2	—
Total for primary government		347,517	89.68
Discretely presented component units:			
Puerto Rico Aqueduct and Sewer Authority		18,024	4.65
Government Development Bank for Puerto Rico		14,519	3.75
Institutional Trust of National Guard of Puerto Rico		3,691	0.95
Puerto Rico Highways and Transportation Authority		181	0.05
Puerto Rico Land Administration		643	0.17
Puerto Rico Solid Waste Authority		589	0.15
State Insurance Fund Corporation		435	0.11
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives		431	0.11
Puerto Rico Infrastructure Financing Authority		208	0.05
Puerto Rico Electric Power Authority		528	0.14
		39,249	10.13
Other governmental entities		762	0.19
Total for all participants	$	387,528	100.00%

The deposits at June 30, 2007 were invested in securities with a cost that approximates fair value, plus accrued interest, for approximately $387.5 million. The external portion of PRGITF was not considered significant for separate reporting in the accompanying basic financial statements.

Following is a table of the investments and other assets held at June 30, 2007, presented at amortized cost (in thousands):

Commercial paper	$	129,203
U.S. government and agencies' obligations		81,400
Securities purchased under agreements to resell		67,638
Corporate obligations		40,146
Certificates of deposits		55,200
Time deposits		12,000
Interest receivable		1,941
Total	$	387,528

(6) Deposits and Investments

Pursuant to the provisions of Act No. 91 of March 29, 2004 the primary government may invest in different types of securities, including domestic, international, and fixed income securities, among others.

The primary government maintains a cash and investment pool that is available for use by all funds, except for the fiduciary funds. Each fund's portion of this pool is reported on the statement of net assets as cash and cash equivalents. The fiduciary funds investments are held and managed separately from those of other primary government funds.

Primary Government

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, bank investment contracts, and deposits invested in PRGITF (see note 5).

The carrying amount of deposits of the primary government at June 30, 2007 consists of the following (expressed in thousands):

		Carrying amount			Bank
		Unrestricted	Restricted	Total	balance
Commercial banks and U.S. Treasury	$	244,729	720,425	965,154	1,477,758
Component unit banks		1,545,941	1,392,826	2,938,767	2,669,076
Total	$	1,790,670	2,113,251	3,903,921	4,146,834

Custodial credit risk is the risk that in the event of bank failure, the primary government's deposit might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by banks in the Commonwealth's name. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

At year-end, the Commonwealth's bank balance of deposits in commercial banks amounting to $936 million was covered by federal depository insurance or by collateral held by the Commonwealth's agent in the Commonwealth's name. Deposits of approximately $541 million with the U.S. Treasury represent unemployment insurance taxes collected from employers that are transferred to the federal Unemployment Insurance Trust Fund in the U.S. Treasury. These deposits are uninsured and

(Continued)

uncollateralized. The bank balance of deposits in component unit banks, which as of June 30, 2007 amounted to approximately \$2.7 billion are also uninsured and uncollateralized. These deposits in component unit's banks are maintained with GDB and EDB. Deposits maintained in GDB and EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk, because in the event of GDB's or EDB's failure, the Commonwealth may not be able to recover these deposits.

Deposits in component units banks represent the balance of interest and noninterest-bearing accounts in GDB and EDB. The deposit liability at GDB and EDB is substantially related to deposits from other component units and of the Commonwealth. The deposit liability does not agree with the governmental cash balances shown above because of reconciling items such as outstanding checks and deposits in transit.

The bank balance of GDB's and EDB's deposits at June 30, 2007 is broken down as follows (expressed in thousands):

Primary government	$	2,239,589
Discretely presented components units		1,840,875
Total pertaining to the Commonwealth		4,080,464
Municipalities of Puerto Rico		567,727
Other nongovernmental entities		911,172
Certificates of indebtedness		11,800
Escrow accounts		186,498
Total deposits per GDB and EDB	$	5,757,661

Unrestricted deposits include approximately \$298.5 million that are invested in PRGITF (see note 5). Such amount has been included as cash and cash equivalents in the primary government's statement of net assets.

Investments

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the transaction, the primary government 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, securities investments were registered in the name of the Commonwealth and were held in the possession of the Commonwealth's custodian bank.

Primary Government

The fair value by investment type, credit quality ratings, and maturity of the unrestricted investments reported by the governmental activities at June 30, 2007 consist of the following (expressed in thousands):

		Fair market value	Investment rating: AAA to A	Investment rating: Not rated	Maturity less than one year
Investment pool	$	31,178	31,178	—	31,178
Guaranteed investment contract		83,685	83,685	—	83,685
PRGITF		48,972	48,972	—	48,972
Other		65	65	—	65
Total investments	$	163,900	163,900	—	163,900

Business-type Activities

The fair value by investment type, credit quality ratings, and maturity of the restricted investments reported by the business-type activities at June 30, 2007 consists of the following (expressed in thousands):

		Fair value	Investment rating: AAA to A	Investment rating: BBB+	Investment rating: Not rated
Mortgage-backed securities	$	5,132	1,676	—	3,456
U.S. government and agency securities		8,044	8,044	—	—
U.S. equity securities		12,199	12,199	—	—
U.S. corporate debt securities		5,216	4,527	689	—
Other		5,015	5,015	—	—
Total	$	35,606	31,461	689	3,456

		Fair value	Maturity (in years): Less than 1 year	1 to 5 years	6 to 10 years	More than 10 years
Mortgage-backed securities	$	5,132	—	—	—	5,132
U.S. government and agency securities		8,044	—	6,797	—	1,247
U.S. equity securities		12,199	12,199	—	—	—
U.S. corporate debt securities		5,216	—	—	5,216	—
Other		5,015	1,697	1,185	—	2,133
Total	$	35,606	13,896	7,982	5,216	8,512

(Continued)

Component Units

Cash, and cash equivalents, of the component units at June 30, 2007 consist of (expressed in thousands):

		Carrying amount		Bank
	Unrestricted	Restricted	Total	balance
Commercial banks	$ 3,135,274	867,106	4,002,380	4,055,620
Component unit banks	629,592	798,283	1,427,875	1,424,517
Total	$ 3,764,866	1,665,389	5,430,255	5,480,137

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

Custodial credit risk is the risk that, in the event of bank failure, the component unit's deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico 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. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

Deposits maintained in GDB and EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of GDB's or EDB's failure, the Commonwealth may not be able to recover the deposits.

The component units were exposed to the following custodial credit risk arising from the balance of deposits maintained in commercial and component unit banks at June 30, 2007 (expressed in thousands):

Uninsured and uncollateralized	$ 4,485,688
Uninsured and collateralized, with securities held by the pledging financial institutions	957,339
Uninsured and collateralized, with securities held by the pledging financial institutions but not in the component unit's name	37,110
Total	$ 5,480,137

Investments

The component units' investment policies allow management to purchase or enter into the following investment instruments:

- U.S. government and agencies obligations
- Certificates and time deposits
- Bankers' acceptances
- Obligations of the Commonwealth of Puerto Rico and municipalities

- Federal funds sold
- Securities purchased under agreements to resell
- World Bank securities
- Corporate debt, including investment contracts
- External investment pools
- Stock of corporations created under the laws of the United States of America or the Commonwealth
- Options, futures, and interest-rates swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products that qualify under any of the foregoing investment categories.
- Open-end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or AAA by Moody's Investors Service
- A few component units, principally SIFC, are also allowed to enter into foreign currency investments, under certain limitations

The component units' investment policies establish limitations and other guidelines on amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country. In addition, such policies provide guidelines on the institutions with which investment transactions can be entered into.

The component units' investment policies provide that investments transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by the Standard & Poor's or equivalent rating by Fitch or Moody's Investors Service, depending on the type and maturity of the investment and the counterparty to the transaction. Also, the investment policy specifies that no more than 5% of a manager's assets at fair value shall be invested in the securities of any single issuer.

All investments in U.S. Treasury securities and mortgage-backed securities guaranteed by GNMA carry the explicit guarantee of the U.S. government and are presented as "not rated' in the table below. The credit qualifying ratings for investments held by the component units at June 30, 2007 are as follows (expressed in thousands):

		Fair value			Investment rating		
		Unrestricted	**Restricted**	**Total**	**Rating AAA to A**	**BBB+**	**Not rated**
Mortgage-backed securities	$	392,498	823,382	1,215,880	1,204,260	265	11,355
U.S. government and agency securities		1,120,902	1,748,253	2,869,155	2,867,473	—	1,682
U.S. sponsored agencies notes		210,574	614,124	824,698	824,698	—	—
Negotiable certificates of deposit		255,987	434,999	690,986	624,581	—	66,405
U.S. corporate stocks		76,069	19,927	95,996	19,927	—	76,069
Non-U.S. corporate stocks		22,027	1,850	23,877	—	—	23,877
U.S. corporate bonds		473,604	74,979	548,583	454,473	84,466	9,644
Commercial paper		10,369	—	10,369	—	10,369	—
Repurchase agreement		20,000	—	20,000	20,000	—	—
Puerto Rico agencies and municipal bonds		8,810	1,423,398	1,432,208	9,741	1,422,467	—
Money market fund		188,016	46,646	234,662	234,662	—	—
Guaranteed investment contract		75,618	1,638,505	1,714,123	998,529	679,743	35,851
PRGITF		15,216	—	15,216	14,786	—	430
Investment pool		339,453	—	339,453	199,441	111,589	28,423
Security lending transactions		207,999	—	207,999	149,018	—	58,981
Investment in other equity securities		472,635	—	472,635	—	—	472,635
Other		148,884	59,097	207,981	6,029	129,986	71,966
Total investments	$	4,038,661	6,885,160	10,923,821	7,627,618	2,438,885	857,318

Certain component units classified approximately $24 million of investments presented in PRGITF as cash and cash equivalents.

The following table summarizes the type and maturities of investments held by the component units at June 30, 2007 (expressed in thousands):

		Maturity (in years)				
	Fair value	Less than 1 year	1 – 5 years	6 – 10 years	More than 10 years	No stated maturity date
Mortgage-backed securities	1,215,880	5,601	105,438	155,850	948,991	—
U.S. government and agency securities	2,869,155	135,288	268,581	227,922	2,237,364	—
U.S. sponsored agencies notes	824,698	115,831	625,127	82,656	1,084	—
Negotiable certificates of deposit	690,986	690,986	—	—	—	—
U.S. corporate stocks	95,996	—	—	—	—	95,996
Non-U.S. corporate stocks	23,877	—	—	—	—	23,877
U.S. corporate bonds	548,583	72,301	238,928	149,019	88,335	—
Commercial paper	10,369	10,369	—	—	—	—
Repurchase agreement	20,000	—	20,000	—	—	—
Puerto Rico agencies and municipal bonds	1,432,208	96,572	374,958	439,295	521,383	—
Money market fund	234,662	187,552	—	—	464	46,646
Guaranteed investment contract	1,714,123	883,688	35,851	—	794,584	—
PRGITF	15,216	15,216	—	—	—	—
Investment pool	339,453	311,365	—	—	—	28,088
Security lending transactions	207,999	149,018	—	—	—	58,981
Investment in other equity securities	472,635	—	—	—	410,840	61,795
Other	207,981	81,015	60,909	—	—	66,057
Total investments	$ 10,923,821	2,754,802	1,729,792	1,054,742	5,003,045	381,440

The component units were exposed to the following custodial credit risk for investments held at June 30, 2007 (expressed in thousands):

Insured or registered	$ 2,653,914
Uninsured and registered, with securities held by the counterparty's trust department or agent in the component units' name	8,173,872
Uninsured and unregistered, with securities held by the counterparty's trust department or agent, but not in the component units' name	96,035
Total	$ 10,923,821

Foreign Currency Risk

SIFC limits its exposure to foreign currency risk by limiting the total amount invested to 5% of the portfolio. The SIFC investments were presented as follow (in thousands):

Investment type	Local currency		Fair value
Money market funds	British pound	$	61
	Hong Kong dollar		73
	Japanese yen		158
		$	292
Common stocks	British pound	$	16,733
	Canadian dollar		1,603
	Danish krone		853
	European monetary unit		20,738
	Hong Kong dollar		2,177
	Japanese yen		15,653
	Norwegian krone		890
	Swedish krone		3,024
	Swiss franc		6,768
	Euro		800
		$	69,239

Unrestricted repurchase agreements of approximately $20 million belong to EDB. As of June 30, 2007, the fair value of the collateral for the repurchase agreements amounted to approximately $20 million for EDB, which consisted primarily of investment securities held in custody by EDB's agent.

Fiduciary Funds

Cash and cash equivalents of the fiduciary funds at June 30, 2007 consist of the following (expressed in thousands):

		Carrying amount			
		Unrestricted	Restricted	Total	Bank balance
Commercial banks and U.S. Treasury	$	730,952	—	730,952	731,252
Component unit banks		459,407	2,310	461,717	468,838
Total	$	1,190,359	2,310	1,192,669	1,200,090

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

Custodial Risk

Custodial credit risk is the risk that, in the event of a bank failure, the fiduciary funds' deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico 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. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

Deposits maintained in component unit banks are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of the component unit bank's failure, the Commonwealth may not be able to recover these deposits.

As of June 30, 2007, $279.4 million was exposed to custodial credit risk. Cash exposed to foreign currency risk as of June 30, 2007 is as follows (expressed in thousands):

Investment type	Currency		Fair value at U.S. dollar currency
Foreign currency	Euro	$	916
Foreign currency	Danish krone		507
Foreign currency	Pound sterling		79
Foreign currency	Japanese yen		75
Foreign currency	Australian dollar		39
Foreign currency	Singapore dollar		5
		$	1,621

Investments

The investment policies of the pension trust funds limit the investment in corporate debt securities to the top rating issued by nationally recognized credit rating organizations. The portfolio is expected to maintain a minimum weighted average credit quality of either "A" or better using either Standard and Poor's or Moody's credit ratings. The following table summarizes the fair value by investment type and maturities of investments held by the pension trust funds at June 30, 2007 (expressed in thousands):

Investments type		Less than 1 year	1 – 5 years	6 – 10 years	More than 10 years	No stated maturity date	Total
Non-U.S. equity securities	$	—	—	—	—	1,254,122	1,254,122
U.S. equity securities		—	—	—	—	2,725,709	2,725,709
U.S. government and agencies securities		113,738	47,793	50,068	191,468	—	403,067
U.S. corporate debt securities		692	66,599	64,638	103,823	—	235,752
Limited partnership/private equity		—	—	—	—	94,470	94,470
Other		—	—	—	—	15,606	15,606
Total	$	114,430	114,392	114,706	295,291	4,089,907	4,728,726

Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table summarizes the credit quality ratings for investments held by the pension trust funds at June 30, 2007 (expressed in thousands):

Investments type		Fair value	AAA to A	BBB+	Not rated
Non-U.S. equity securities	$	1,254,122	—	—	1,254,122
U.S. equity securities		2,725,709	—	—	2,725,709
U.S. government and agencies securities		403,067	398,403	469	4,195
U.S. corporate debt securities		235,752	142,397	88,051	5,304
Limited partnership/private equity		94,470	—	—	94,470
Other		15,606	—	—	15,606
Total	$	4,728,726	540,800	88,520	4,099,406

At June 30, 2007, securities investments amounting to $4.7 billion were registered in the name of the pension trust funds and were held in the possession of the pension's trust funds custodian banks.

The investment in non-U.S. stocks is expected to achieve long-term, aggressive capital appreciation by investing in Core EAFE (Europe Australasia and the Far East) securities. The portfolio is expected to be broadly diversified with respect to exposures to countries, economic sectors, industries, and individual stock. No single issue is expected to exceed 5% (at market) of the portfolio.

Investments exposed to foreign currency risk as of June 30, 2007 are as follows (expressed in thousands):

Investment type	Currency		Fair value at U.S. dollar currency
Equity securities	Euro	$	360,279
Equity securities	Japanese yen		270,355
Equity securities	British pound sterling		260,959
Equity securities	Swiss franc		87,106
Equity securities	Swedish krone		51,919
Equity securities	Australian dollar		40,065
Depository receipts	Commingled		37,285
Equity securities	Hong Kong dollar		23,338
Equity securities	Norwegian krone		21,479
Equity securities	Singapore dollar		13,926
Equity securities	Danish krone		12,365
Equity securities	Brazilian real		11,071
Equity securities	Chinese yuan		10,325
Equity securities	Indian rupees		8,719
Equity securities	Canadian dollar		7,151
Mutual funds	British pound sterling		6,844
Equity securities	Mexican pesos		6,023
Equity securities	Russian rubles		5,679
Preferred stock	Swiss franc		3,517
Equity securities	Polish zlotys		3,499
Equity securities	South Korean won		3,212
Equity securities	Indonesian rupiahs		2,753
Equity securities	Danish kroner		2,353
Equity securities	Turkey lira		1,262
Equity securities	South African rand		803
Equity securities	Taiwan new dollars		803
Equity securities	Malaysian ringgits		459
Equity securities	Colombian pesos		287
Equity securities	Cyprus pounds		229
Equity securities	New Zealand dollar		57
		$	1,254,122

(7) Securities Lending Transactions

During the year, the pension trust funds, included within the fiduciary funds, SIFC and AACA, two discretely presented component units, entered into securities lending transactions. These transactions are explained below:

Pension Trust Funds

The Retirements System participates in a security lending program whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, government securities, and irrevocable bank letters of credit equal to approximately 102% of the market value of the domestic securities on loan and 105% of the market value of the international securities on loan, with a simultaneous agreement to return the collateral for the same securities in the future. Collateral is marked to market daily, and the agent places a request for additional collateral from brokers if needed. The custodian bank is the agent for the securities lending program.

Securities lending obligations for which collateral was received as of June 30, 2007 consist of the following (expressed in thousands):

Securities lent		Fair value of underlying securities
U.S. corporate debt securities	$	17,370
U.S. government securities		25,145
U.S. equity securities		198,844
Non-U.S. equity securities		57,915
	$	299,274

The collateral received amounted to approximately $309 million. The collateral securities cannot be pledged or sold unless the borrower defaults; therefore, these transactions are not reported as assets and liabilities in the statements of fiduciary net assets. Collateral received was invested as follows (expressed in thousands):

Collateral		Fair value
Commercial paper	$	114,327
Certificate of deposit		65,015
Corporate		44,529
Bank note		4,665
TD		10,339
Repo		7,718
ABCP		1,611
CP		2,236
Reverse repurchase agreement U.S. agency delivered		6,577
Reverse repurchase agreement U.S. mortgage-backed triparty		52,000
	$	309,017

The relationship between the investment maturities and the Retirement Systems' loans cannot be determined.

At year-end, the Retirement Systems have no credit risk exposure to borrowers because the amounts that the Retirement Systems owe the borrowers exceed the amounts the borrowers owe to the Retirement Systems. The Retirement Systems' rights to collateral are defined in the contractual agreements. The borrower's creditworthiness is also proactively reviewed by the lending agent.

Component Units

SIFC

The Commonwealth statutes and the SIFC's board of directors' policies permit SIFC to use its investments to enter into securities lending transactions. The SIFC's securities custodian, as agent of SIFC, manages the securities lending program and receives cash, securities, or irrevocable bank letters of credit as collateral. The collateral securities cannot be pledged or sold by SIFC unless the borrower defaults. The collateral requirement is equal to 102% for securities issued in the United States of America and 105% for securities issued outside of the United States of America of the fair value of the securities lent. Additional collateral has to be provided by the next business day if its value falls to less than 100% of the fair value of the securities lent. At year-end, SIFC has no credit risk exposure to borrowers because the amounts SIFC owes the borrowers exceed the amounts the borrowers owe SIFC. Contracts with the lending agents require them to indemnify SIFC if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay SIFC for income distributions by the securities' issuers while the securities are on loan.

All security loans can be terminated on demand by either SIFC or the borrower, although the average term of the loans is two weeks. In lending securities, the term to maturity of the securities loans is matched with the term to maturity of the investment of the cash collateral. Such matching existed at year-end. Securities lending obligations for which cash was received as collateral as of June 30, 2007 consist of the following (expressed in thousands):

Securities lent		Fair value of underlying securities
Equity securities	$	38,869
U.S. government, agencies, instrumentalities obligations		90,760
Corporate bonds and notes		17,650
	$	147,279

Cash collateral received amounted to $149 million and it was invested in repurchase agreements. These secured lending activities are included in the accompanying statement of net assets, since cash was received as collateral but reinvested as explained above.

In addition, SIFC had the following securities lending obligations collateralized by securities as of June 30, 2007 (expressed in thousands):

Securities lent		Fair value of underlying securities	Securities collateral received
U.S. government, agencies, instrumentalities obligations	$	67,032	72,325

These securities lending transactions are collateralized by securities that cannot be pledged or sold unless the borrower defaults; therefore, they are not reported as assets and liabilities in the accompanying balance sheets.

AACA

AACA lends securities to broker/dealers and other entities (borrowers) for collateral that will be returned in the future for the same securities. The custodial bank manages the securities lending program and receives cash, government securities, and letters of credit as collateral. The program provides for an initial minimum collateralization of 102% of the market value of the securities lent plus accrued income. Additional collateral has to be provided by the close of the next business day if its value falls to less than 100%. The contract with the custodial bank requires that should a collateral deficiency occur beyond the custodian's responsibilities, the deficiency should be allocated pro rata among all client lenders within the program.

Either the custodian bank or the borrower can terminate all security loans at any time. Cash collateral is invested in the program's agent short-term investment pools, which at fiscal year-end had a weighted average maturity of approximately 30 days. The relationship between securities of the investment pool and AACA loans cannot be determined.

The following represents the balances relating to the securities lending transactions as of June 30, 2007 (expressed in thousands):

Securities lent		Fair value of underlying securities	Cash collateral received	Noncash collateral received
U.S. Treasury bills, bonds, and notes	$	29,478	28,618	1,400
Common stocks and preferred stocks		27,302	27,380	612
Corporate bonds		800	823	—
U.S. agencies		2,121	2,160	—
Total	$	59,701	58,981	2,012

Secured lending transactions where cash collateral was received and reinvested are presented as assets and liabilities in the accompanying statement of net assets. Securities lending transactions collateralized by noncash collateral cannot be pledged or sold unless the borrower defaults are not reported as assets or liabilities in the statement of net assets. At year-end, AACA has no credit risk exposure to borrowers because the amounts AACA owes the borrowers exceed the amounts the borrowers owe AACA.

(8) Investments in Limited Partnerships

Pursuant to the Statement of Investment Guidelines for the Government of Puerto Rico, the pension trust funds and a component unit invested approximately $17.3 million in limited partnerships during the year ended June 30, 2007. The investments were as follows:

- During fiscal year 2007, there were $403,873 contributions made during fiscal year 2007 in Guayacán Funds of Funds, L.P., a Delaware limited partnership, organized by Grupo Guayacán, Inc. as general partner, which has total commitments of $55.5 million (of which $45 million are from pension trust funds and the remaining balances from private corporate invetors). This fund invests in the United States of America and international private equity partnerships that in turn invest in private companies.

- During fiscal year 2007, $7.5 million was invested in Guayacán Fund of Funds II, L.P., a Delaware limited partnership, organized by Grupo Guayacán, Inc. as general partner, that has total commitments of $62 million (of which $50 million are from the pension trust funds and the remaining balances from private corporate invetors). The fund invests in a broad range of U.S. and international private equity investment partnerships that, in turn, will make equity and equity-related investments primarily in private businesses.

- During fiscal year 2007, there were no contributions in Guayacán Private Equity Fund, L.P., a Delaware limited partnership, organized by Advent-Morro Equity Partners, Inc. as general partner, that has total commitments of $42 million (of which $10 million are from the pension trust funds, $22.5 million are from component units and the remaining balance from the private corporate investors in Puerto Rico). This fund invests in Puerto Rico private equity.

- During fiscal year 2007, $4 million was invested in Guayacán Private Equity Fund, L.P. II, a Delaware limited partnership, organized by Advent/Morro Partners as general partner, has total commitments of $54 million (of which $35 million are from components units, $15 million are from pension trust funds and the remaining balance from the private corporate investors in Puerto Rico). This fund invests in Puerto Rico private equity.

- During fiscal year 2007, $251,000 was invested in Invesco Venture Partnership Fund III, L.P., a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as general partner in which the pension trust fund has a total commitment of $5.5 million. The partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily U.S. and international funds that focus on both early- and later-stage venture capital investments.

- During fiscal year 2007, there were no contributions to Invesco Non-U.S. Partnership Fund III, L.P., a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as general partner, in which the pension trust fund has a total commitment of $4.5 million. The partnership was organized to invest in other collective investments funds investing in alternative assets, including primarily investments focusing on non-U.S. buyouts, expansion capital, turnaround, mezzanine, and distressed investment partnership.

- During fiscal year 2007, $354,000 was invested in Invesco U.S. Buyout & Expansion Capital Partnership Fund III, L.P., a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as general partner, in which the pension trust fund has a total commitment of $3.7 million. The partnership was organized to invest in other collective funds investing in alternative assets, including primarily investments focusing on small, mid-size, and large domestic buyout transactions.

- During fiscal year 2007, $534,000 was invested in Chase Capital Partners Private Equity Fund of Funds II, LTD, a limited partnership, organized by Chase as general partner, in which the pension trust fund has a total commitment of $15 million. The fund's investment strategy is to capitalize on a globally diversified portfolio of private equity investments opportunities across various sectors, including buyouts, growth equity, venture capital and other special situations through partnership, investments, and direct investments.

- During fiscal year 2007, there were no additional contributions to Venture Capital Fund, Inc., a Puerto Rico Corporation, organized pursuant to Act No. 3 of October 6, 1987, as amended, known as the Puerto Rico Capital Investment Funds Act that is managed by Advent-Morro Equity Partners (Advent-Morro Equity Partners, Inc.) in which the pension trust fund has a total commitment of $800,000. Advent-Morro is a Puerto Rico based private equity firm. The fund was created to make private equity investments in operating companies that are based, or are operating or a combination of both, in Puerto Rico. Since inception, the fund has invested in 25 companies some of which it continues to provide capital for their expansion.

- During fiscal year 2007, $3.1 million was invested in GF Capital Private Equity Fund, L.P., a limited partnership, organized under the laws of the State of Delaware, in which the pension trust fund 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 million to $400 million with a representation of buyouts, growth capital, and recapitalizations.

- During fiscal year 2007, $1.1 million was 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 pension trust fund 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 fair value of these investments at June 30, 2007 amounted to $94.5 million and is presented within investments in the statement of fiduciary net assets. The fair values of these investments have been estimated by the corresponding general partner or fund manager of these partnerships and disclosed in its respective separate audited financial statements. The allocations of net gain and net loss to the limited partners are based on certain percentages, as established in the limited partnership agreements. The difference between the fair value of the investments and the total cumulative contributions is mostly due to distributions made.

As of June 30, 2007, the pension trust funds and discretely presented component units had capital commitments and contributions as follows (expressed in thousands):

Guayacán Funds of Funds, L.P.		Public sector commitments	Fiscal year contributions	Cumulative contributions
Primary government:				
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	$	25,000	224	23,503
Puerto Rico System of Annuities and Pensions for Teachers		20,000	180	18,803
Subtotal		45,000	404	42,306
Guayacán Funds of Funds II, L.P.				
Primary government:				
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	$	25,000	3,772	23,411
Puerto Rico System of Annuities and Pensions for Teachers		25,000	3,772	23,411
Subtotal		50,000	7,544	46,822

Guayacán Private Equity Fund, L.P.		Public sector commitments	Fiscal year contributions	Cumulative contributions
Primary government:				
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities		5,000	—	4,407
Puerto Rico System of Annuities and Pensions for Teachers		5,000	—	4,407
Component unit:				
Economic Development Bank for Puerto Rico		20,000	—	17,625
UPR Employees Retirement System		2,500	—	2,203
Subtotal		32,500	—	28,642
Guayacán Private Equity Fund, L.P. II				
Primary government:				
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities		15,000	1,200	1,200
Component unit:				
Economic Development Bank for Puerto Rico		20,000	1,600	1,600
State Insurance Fund Corporation		10,000	800	800
UPR Employees Retirement System		5,000	400	400
Subtotal		50,000	4,000	4,000
Other Funds				
Primary government:				
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities		47,596	4,193	23,690
Puerto Rico System of Annuities and Pensions for Teachers		28,714	1,139	24,687
Subtotal		76,310	5,332	48,377
Total	$	253,810	17,280	170,147

(Continued)

(9) Receivables and Payables

Receivables in the governmental funds include approximately $1.3 billion of accrued income, excise and sales and use taxes. Other receivables are $704 million receivable from the federal government and $11.8 million from the CRIM. In addition, the enterprise funds include $58.9 million of unemployment, disability, and drivers' insurance premium receivable.

Payables in the governmental funds include approximately $1.2 billion of trade accounts due to suppliers for purchase of merchandise and services rendered, $312 million of tax refunds liability, and $32 million of other payables. Also at June 30, 2007, excess of checks drawn over the pooled bank balance amounted to approximately $809 million and is reported within accounts payable and accrued liabilities of the governmental activities.

In accordance with GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issue* (the TB), a receivable of $37 million was recorded as other receivable in the government-wide financial statements for estimated shipments from January 1 to June 30, 2007, which will be applied to debt service upon collection. Additionally, the TB indicated that the Trust designated as the Tobacco Settlement Authority (TSA) should recognize a liability for the bonds payable and an expense (and liability if unpaid) in the same period in its stand-alone financial statements. The expense (and liability if unpaid) recognizes the contractual obligation to remit the proceeds of the bond sold. Since the Trust is reported as a blended component unit, the TB indicates these remittances should be reported as transfers into the fund receiving the proceeds and transfers out in the fund that accounts for the activities of the TSA. Since the Trust has no contractual obligation, under its enabling legislation or elsewhere, to remit all bond proceeds or assets related to the GSA to the settling government (the Commonwealth), the Trust has not recognized an expense and liability for unpaid proceeds from the bonds since it records the expense as amounts are disbursed as grants to its settling government (including its instrumentalities) or third parties.

(10) Interfund and Intraentity Transactions

Interfund receivables and payables at June 30, 2007 are summarized as follows (expressed in thousands):

Receivable fund	Payable fund		Amount
Nonmajor governmental fund	General fund	$	178,011
Lotteries	General fund		53,175
General fund	Lotteries		61,446
		$	292,632

Transfers from (to) other funds for the year ended June 30, 2007 are summarized as follows (expressed in thousands):

Transferee fund	Transferor fund		Amount
General	Nonmajor governmental	$	335,789
General	Unemployment insurance		169,933
General	Lotteries		197,044
Nonmajor governmental	General		162,153
PBA capital projects	General		145,813
Debt service	General		82,386
General	The Children's Trust special revenue		71,627
Lotteries	General		16,863
Nonmajor enterprise	General		7,458
The Children's Trust special revenue	General		243
General	Nonmajor enterprise		87
		$	1,189,396

The principal purposes of the interfund transfers are to (expressed in thousands):

1. Distribute the increase in net assets of the lotteries fund for the use of the general fund, as required by the lotteries enabling legislation ($197,044).

2. Unemployment insurance fund's distribution of surplus cash belonging to the general fund for the payment of administrative expenses ($169,933).

3. Recognize as transfers the rental payments made by the Commonwealth's agencies on properties leased by PBA, a blended component unit of the Commonwealth ($162,153) to the nonmajor funds of PBA and $145,813 to the PBA capital project fund.

4. Make funds available for debt service payments in the debt service fund ($82,386).

5. Transfer from The Children's Trust special revenue fund to the general fund in order to provide financial assistance to carry out project aimed at promoting the well-being of children and youth of Puerto Rico ($71,627)

6. Transfer from the general fund to Additional Lottery to cover prizes settlement pursuant Act No. 171 of July 28, 2004 ($16,863).

7. Transfer from (a non major governmental fund, mainly the capital project fund) for repayment of the general fund's lines of credit, pursuant to such line of credit agreement ($335,789).

8. To provide local matching funds from the general fund related to the federal capital grants of the Puerto Rico Water Pollution Revolving Fund and Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, two nonmajor enterprise funds of the Commonwealth ($7,458).

9. Transfer of $243 from the tobacco settlement asset-backed bonds debt service fund to The Children's Trust special revenue fund in order to provide funds for operating expenses.

10. Transfer of $87 from the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund to the general fund attributed to a reimbursement representing an excess matching contribution corresponding to previous years.

Interfund receivables and payables represent the pending settlements of the aforementioned transfers or transactions from prior years.

Due from (to) primary government and component units are as follows (expressed in thousands):

Receivable entity/fund	Amount	Payable entity/fund	Amount
Business-type activities	$ 229,173	Puerto Rico Aqueduct and Sewer Authority	$ 229,173
		Cardiovascular Center Corporation of Puerto Rico and the Caribbean	44,074
		Puerto Rico Medical Services Administration	43,070
		Puerto Rico Health Insurance Administration	27,600
		Puerto Rico Tourism Company	22,178
		Employment and Training Enterprises Corporation	7,108
Governmental activities	149,545	Governing Board of the 911 Service	5,515
	$ 378,718		$ 378,718
Puerto Rico Electric Power Authority	$ 175,645	Governmental activities	$ 495,610
Puerto Rico Health Insurance Administration	148,900		
University of Puerto Rico	95,853		
Puerto Rico Medical Services Administration	33,983		
Puerto Rico Industrial Development Company	23,403		
Puerto Rico Conservatory of Music	14,189		
Land Authority of Puerto Rico	3,637		
	$ 495,610		$ 495,610

The amount owed by PRASA of $229 million represents construction loans granted by the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, nonmajor enterprise funds, to finance the construction of capital assets for PRASA.

The amount receivable by PREPA from the primary government includes approximately $43 million representing an agreement with the Commonwealth by which the Commonwealth will pay the outstanding fuel adjustment subsidy and certain other accumulated debt. The amount owed by the Commonwealth is presented within notes payable in the statement of net assets of the governmental activities.

The amount receivable by the UPR from the primary government includes a resolution approved by the Legislature of the Commonwealth to pay $94.7 million to the UPR on behalf of the Department of Health of the Commonwealth over eight years, including the financing of additional debts of approximately $71.2 million. The related outstanding balance of $63.8 million is presented by the Commonwealth within notes payable in the statement of net assets of the governmental activities.

Due from (to) component units are as follows (expressed in thousands):

Receivable entity/fund	Amount	Payable entity/fund	Amount
Puerto Rico Electric Power Authority	$ 31,909	Puerto Rico Medical Services Administration	$ 44,054
University of Puerto Rico	19,337	Cardiovascular Center Corporation of Puerto Rico and the Caribbean	7,192
State Insurance Fund Corporation	3,500	Puerto Rico Solid Waste Authority	3,500
Puerto Rico Land Administration	3,916	Puerto Rico Industrial Development Company	3,916
Farm Insurance Corporation of Puerto Rico	13,257	Agricultural Services and Development Administration	16,180
Land Authority of Puerto Rico	9,354	Farm Insurance Corporation of Puerto Rico	6,431
	81,273	Sub total	81,273
Governmental Development Bank for Puerto Rico	1,475,582	Special Communities Perpetual Trust	385,152
		Puerto Rico Sales Tax Financing	303,024
		Corporation Authority	155,221
		Puerto Rico Aqueduct and Sewer Authority	139,524
		Agricultural Services and Development Administration	127,578
		Puerto Rico Industrial Development Company	81,075
		Puerto Rico Solid Waste Authority	59,497
		Puerto Rico Infrastructure Financing Authority	53,290
		Puerto Rico Electric Power Authority	49,489
		University of Puerto Rico	37,271
		Land Authority of Puerto Rico	36,741
		Institute of Puerto Rican Culture	22,756
		Economic Development Bank for Puerto Rico	11,876
		National Parks Company of Puerto Rico	3,830
		Puerto Rico Ports Authority	2,750
		Puerto Rico Convention Center District	
			1,469,074
	$ 1,556,855		$ 1,550,347

The difference amounting to $6.5 million between due from (to) component units resulted from the time lag between the dates that transactions are recorded by each discretely presented component unit and other reconciling items. The balance due to GDB amounting to approximately $1.5 billion represents loans payable to GDB at June 30, 2007.

The rest of the loans receivable reported by GDB consists of the following (expressed in thousands):

Primary government – governmental activities	$	3,422,137
Other governmental entities and municipalities		926,338
Private sector (net of $10,206 presented within restricted assets)		407,498
Total loans receivable reported by GDB	$	4,755,973

The loans to the primary government are presented by the Commonwealth within notes payable in the statement of net assets.

Expenses of the primary government include approximately $2.6 billion in capital and operational contributions made by the primary government to the component units comprise the following (expressed in thousands):

Puerto Rico Health Insurance Administration	$	1,142,347
University of Puerto Rico		861,503
Puerto Rico Infrastructure Financing Authority		98,320
Government Development Bank for Puerto Rico		65,850
Puerto Rico Aqueduct and Sewer Authority		700
Nonmajor component units		445,345
Total contributions made by primary government to component units	$	2,614,065

(11) Restricted Assets

Restricted assets of the primary government included in the basic financial statements at June 30, 2007 consist of cash, investments, and other assets to be used for the following purposes (expressed in thousands):

Debt service and sinking fund	$	1,490,524
Public Housing Administration – funds received from HUD		450,112
Assets held in trust for repayment of QZAB		73,051
Construction and betterment funds		50,036
Investment held for disability insurance benefits		35,606
Construction of governmental facilities		29,754
Assets held for development of urban forest		19,200
Emergency fund		574
Other		33,605
	$	2,182,462

Liabilities of the primary government payable from restricted assets consist of the following (expressed in thousands):

Governmental activities:		
Qualified Zone Academic Bonds	$	184,124
Tax revenue anticipation notes		881,484
Deferred revenue		108,970
Interest payable		564,623
Liabilities payable from restricted assets – governmental activities	$	1,739,201
Business-type activities:		
Disability insurance benefit payable	$	851
Liabilities payable from restricted assets – business-type activities	$	851

Governmental activities restricted net assets:		
Restricted for capital project	$	11,601
Restricted for debt service		159,817
Other purpose		159,633
Total restricted net assets	$	331,051

Restricted assets of the component units included in the basic financial statements at June 30, 2007 are to be used for the following purposes (expressed in thousands):

Debt service and sinking fund requirements	$	5,566,347
Construction and betterments funds		1,977,951
Collateral for underlying securities		716,800
Other uses		164,914
Educational fund		148,774
Malpractice insurance fund		73,461
Maintenance reserve fund		51,649
Industrial incentives		4,446
Escrow		145
Incentive to farmers		2
Total for components units	$	8,704,489

(12) Capital Assets

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

Primary Government

	Beginning balance (as restated)	Increases	Decreases	Ending balance
Governmental activities:				
Capital assets, not being depreciated:				
Land	$ 848,443	9,108	13,018	844,533
Construction in progress	1,396,503	401,727	363,252	1,434,978
Total capital assets, not being depreciated	2,244,946	410,835	376,270	2,279,511
Capital assets, being depreciated:				
Buildings and building improvements	6,595,302	362,624	32,553	6,925,373
Equipment furniture, fixtures and vehicles	390,631	68,329	8,850	450,110
Infrastructure	441,500	—	—	441,500
Total capital assets, being depreciated	7,427,433	430,953	41,403	7,816,983
Less accumulated depreciation for:				
Buildings and building improvements	2,200,152	190,207	18,554	2,371,805
Equipment furniture, fixtures and vehicles	190,418	36,654	3,012	224,060
Infrastructure	83,951	8,830	—	92,781
Total accumulated depreciation	2,474,521	235,691	21,566	2,688,646
Total capital assets, being depreciated, net	4,952,912	195,262	19,837	5,128,337
Governmental activities capital assets, net	$ 7,197,858	606,097	396,107	7,407,848
Business-type activities:				
Total capital assets, being depreciated – equipment	$ 5,043	—	233	4,810
Less accumulated depreciation of equipment	4,035	334	233	4,136
Total business-type activities capital assets, being depreciated, net	$ 1,008	(334)	—	674

Depreciation expense was charged to functions/programs of the primary government for the year ended June 30, 2007 as follows (expressed in thousands):

Governmental activities:		
General government	$	76,697
Public safety		24,112
Health		6,297
Public housing and welfare		83,684
Education		30,374
Economic development		14,527
Total depreciation expense – governmental activities	$	235,691
Total depreciation business-type activities – lotteries	$	334

The net book value of capital assets of the primary government as of beginning of the year was increased to reflect the noncapitalization of capital assets payable by approximately $14.7 million.

The Commonwealth follows the provision of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, an amendment to GASB Statement No. 34. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries. The Commonwealth recognized an impairment loss of $3.4 million in the statement of activities, related to the reduction in use of educational facilities.

General infrastructure assets include $417 million representing the estimated cost of assets transferred to the Department of Natural and Environmental Resources (DNER) of the Commonwealth in 1997 upon completion of the Cerrillos Dam and Reservoir and the Portugues-River and Bucana-River Projects by the U.S. Army Corps of Engineers. These infrastructure assets are reported within governmental activities and include dams, intake facilities, and similar items built for flood control, water supply, and recreational purposes. The Commonwealth also recorded a payable due to the U.S. Army Corps of Engineers, amounting to $205 million, for its estimated allocated share of the construction costs associated with these projects, including accrued interest of $5 million. The final debt agreement between DNER and the U.S. Army Corps of Engineers has not been finalized, and therefore, terms and conditions could differ from those estimated. The depreciation is computed using the straight-line method over an estimated useful life of 50 years from the transfer date of the property. The related debt is expected to be payable on an annual basis over a 50-year period. However, the debt has been presented as a long-term payable after one year in the accompanying statement of net assets since the commencement date of repayment has not yet been determined.

On August 17, 2001, the Legislature of the Commonwealth approved Act No. 120, which requires the conditional transfer of the ownership of certain real properties under the name of the Department of Recreation and Sports (DRS) of the Commonwealth to the municipalities of the Commonwealth. The land and the facilities were transferred at no cost to the municipalities. During fiscal year ended June 30, 2007, land, building, and building improvements with a total carrying amount of $29 million were transferred to several municipalities and recorded as an expense in the accompanying statement of activities.

Discretely Presented Component Units

	Beginning balance (as restated)	Increases	Decreases	Ending balance
Capital assets, not being depreciated:				
Land	$ 2,539,366	135,565	46,119	2,628,812
Art works	8,603	4	—	8,607
Construction in progress	6,238,211	1,858,801	1,691,305	6,405,707
Total capital assets, not being depreciated	8,786,180	1,994,370	1,737,424	9,043,126
Capital assets, being depreciated:				
Buildings and buildings improvements	8,958,948	397,789	240,311	9,116,426
Equipment, furniture, fixtures and vehicles	1,308,083	383,340	31,386	1,660,037
Infrastructure	22,576,754	1,199,151	3,004	23,772,901
Total capital assets, being depreciated	32,843,785	1,980,280	274,701	34,549,364
Less accumulated depreciation for:				
Buildings and buildings improvements	5,047,766	369,497	207,611	5,209,652
Equipment, furniture, fixtures and vehicles	769,522	132,778	21,578	880,722
Infrastructure	9,141,492	654,946	2,420	9,794,018
Total accumulated depreciation	14,958,780	1,157,221	231,609	15,884,392
Total capital assets, being depreciated, net	17,885,005	823,059	43,092	18,664,972
Capital assets, net	$ 26,671,185	2,817,429	1,780,516	27,708,098

The restatements in the beginning balance of capital assets by approximately $60.3 million is related to several component units sustaining restatements included in note 4.

(13) Tax Revenue Anticipation Notes Payable

Tax revenue anticipation notes (TRANS) reported in the general fund were issued on October 26, 2006 at interest rates of 4.5% and were paid on July 30, 2007. The TRANS amounted to $881 million at June 30, 2007 plus accrued interest of approximately $27 million. The proceeds of the TRANS were used to cover temporary cash deficiencies resulting from the timing differences between tax collections and the payments of current expenditures.

(Continued)

(14) Short and Long-Term Obligations

Primary Government

(a) Summary of Short and Long-Term Obligations

Short and long-term obligations at June 30, 2007 and changes for the year then ended are as follows (expressed in thousands):

	Balance at June 30, 2006	Debt issued	Capitalized interest	Debt paid	Original issue (discounts) premiums	Other net increases (decreases)	Balance at June 30, 2007	Due within one year
Governmental activities:								
General obligation and revenue bonds	$ 12,195,083	1,065,390	31,247	(303,360)	21,233	24,809	13,034,402	318,380
Commonwealth appropriation bonds	2,642,194	—	1,551	(84,189)	—	3,836	2,563,392	99,971
Qualified Zone Academy Bonds	184,124	—	—	—	—	—	184,124	—
Notes payable to component units:								
GDB (short term)	526,044	100,233	—	(327,202)	—	—	299,075	299,075
GDB	3,179,083	433,231	—	(489,252)	—	—	3,123,062	413,254
Other	114,651	—	—	(7,785)	—	—	106,866	36,009
Total bonds and notes payable	18,841,179	1,598,854	32,798	(1,211,788)	21,233	28,645	19,310,921	1,166,689
Compensated absences	1,683,953	—	—	(962,323)	—	1,072,485	1,794,115	1,065,805
Net pension obligation	4,740,806	—	—	—	—	355,518	5,096,324	—
Obligation under capital lease arrangements	144,501	2,975	—	(4,663)	—	(1,002)	141,811	4,808
Other liabilities:								
Employees' Christmas bonus	102,562	—	—	(175,821)	—	173,333	100,074	100,074
Liability for federal cost disallowances	53,047	—	—	—	—	(2,888)	50,159	50,159
Liability for legal claims and judgments	801,167	—	—	(26,076)	—	175,185	950,276	26,000
Other	205,000	—	—	—	—	—	205,000	—
Total governmental activities	26,572,215	1,601,829	32,798	(2,380,671)	21,233	1,801,276	27,648,680	2,413,535
Business-type activities:								
Compensated absences	7,365	—	—	(3,857)	—	2,489	5,997	3,945
Obligation for unpaid lottery prizes	303,703	—	—	(37,488)	—	26,075	292,290	55,377
Claims liability for insurance benefits	70,973	—	—	(70,973)	—	57,915	57,915	57,915
Total business-type activities	382,041	—	—	(112,318)	—	86,479	356,202	117,237
Total governmental and business-type	$ 26,954,256	1,601,829	32,798	(2,492,989)	21,233	1,887,755	28,004,882	2,530,772

(Continued)

The balances of long-term debt issued included within other financing sources and debt service principal expenditures as reported in the statement of revenue, expenditures, and changes in fund balances – governmental funds do not agree with amounts reported as debt issued and paid in the above table primarily because the above table includes debt issued and paid on short-term obligations, which amounted to approximately $100.2 million and $327.2 million, respectively. The receipt and payment of short-term obligations is reported as a balance sheet transaction in the fund financial statements.

The other net increases in bonds and notes payable consist of deferred losses on refunding, net of amortization, and net amortization of premiums and discounts on bonds. These adjustments did not require any source or use of cash.

Compensated absences, net pension obligation, obligation for unpaid lottery awards, liability for insurance benefits, and other long-term liabilities reflect other net increases (decreases) resulting from adjustments and changes to agree these obligations to their new estimated balances at June 30, 2007.

(b) Debt Limitation

The Constitution of the Commonwealth authorizes the contracting of debts as determined by the Legislature. Nevertheless, the Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit, and taxing power of the Commonwealth are not to be issued if the amounts of the principal of, and interest on, such bonds and notes and on all such bonds and notes issued thereafter, which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenue raised under the provisions of Commonwealth legislation and conveyed into the Treasury (hereinafter internal revenue) in the two fiscal years preceding the then current fiscal year. Section 2, Article VI of the Constitution does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. Internal revenue consists principally of income taxes and excise taxes. Certain revenue, such as federal excise taxes on offshore shipments of alcoholic beverages, tobacco products, and customs duties, which are collected by the U.S. government and returned to the Commonwealth, motor vehicle fuel taxes and license fees, which are allocated to the PRHTA, a discrete component unit, and a portion of the sales and use tax allocated to service the bonds issued by COFINA are not included as revenue for the purpose of calculating the debt limit, although they may be available for the payment of debt service. At June 30, 2007, the Commonwealth is in compliance with the debt limitation requirement.

(c) Bonds Payable

The Constitution of the Commonwealth provides that public debt will constitute a first claim on the available revenue of the Commonwealth. Public debt includes general obligations and notes of the Commonwealth and any payment required to be made by the Commonwealth under its guarantees of bonds issued by blended or discretely presented component units. The good faith, credit, and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal and interest of the general obligation bonds.

Act No. 83 of August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. The levy is made by CRIM, a municipal corporation, not a component unit of the Commonwealth. CRIM is required to remit the 1.03% of property tax collected to the Commonwealth to be used by the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth. During the year ended June 30, 2007, the total revenue and receivable reported by the Commonwealth amounted to approximately $120 million and $11.8 million, respectively, which are included in the debt service fund.

For financial reporting purposes, the outstanding amount of bonds represents the total principal to be repaid, net of unamortized premiums, discount, and deferred refunding losses; for capital appreciation bonds, it represents total principal and accreted interest to be repaid.

Bonds payable outstanding at June 30, 2007 are as follows (expressed in thousands):

		General obligation	Revenue bonds	Total
Term bonds payable through 2036; interest payable semiannually at rates varying from 3% to 8%.	$	3,293,025	1,588,655	4,881,680
Serial bonds payable through 2024; interest payable semiannually at rates varying from 3.75% to 7.50%.		4,519,080	1,054,740	5,573,820
Capital appreciation bonds payable through 2031; no interest rate, yield ranging from 4.42% to 7.80%. Net of accreted discount of $168 million.		239,160	143,987	383,147
The Children's Trust Fund tobacco settlement asset-backed bonds payable through 2026; interest payable annually at rates varying from 4.625% to 6.000%.		—	1,234,904	1,234,904
Capital Fund Program Bonds, maturing in various dates payable through 2024; interest payable at rates varying from 2% to 5%.		—	619,105	619,105
Bond payment obligation payable through 2010; interest payable at rates varying from 1.5% to 5.5%.		125,910	—	125,910
Balance carried forward	$	8,177,175	4,641,391	12,818,566

		General obligation	Revenue bonds	Total
Balance brought forward	$	8,177,175	4,641,391	12,818,566
Yield curve bonds payable from 2009 through 2011; no interest rate, yield of 8.914%.		15,000	—	15,000
Yield retail bonds payable from 2009 through 2011; interest payable at rates varying from 2.875% to 5.000%.		21,000	—	21,000
Tax-exempt components maturing through 2007 and 2008; interest payable at rates ranging from 5.5% to 5.6%.		—	72,160	72,160
Inverse rate bonds payable from 2009 through 2011; interest payable at a rate of 6%.		15,000	—	15,000
Insured bonds payable from 2014 through 2018; interest payable at a rate of 5%.		64,360	—	64,360
Total		8,292,535	4,713,551	13,006,086
Unamortized premium, net		222,319	17,836	240,155
Deferred charges arising from debt refunding		(66,284)	(145,786)	(212,070)
Savings bonds		231	—	231
Total bonds payable	$	8,448,801	4,585,601	13,034,402

During the year ended June 30, 2007, the following changes occurred in the bonds payable (expressed in thousands):

	Outstanding at June 30, 2006	Issued	Premiums/ discount (redemptions)	Outstanding at June 30, 2007
Term bonds	$ 4,406,850	517,125	(42,295)	4,881,680
Serial bonds	5,189,555	548,265	(164,000)	5,573,820
Capital appreciation bonds	419,634	—	(36,487)	383,147
The Children's Trust Fund tobacco settlement asset-backed bonds	1,239,015	—	(4,111)	1,234,904
Capital Fund Program Bonds	641,325	—	(22,220)	619,105
Bond payment obligations	125,910	—	—	125,910
Yield curve bonds	15,000	—	—	15,000
Yield retail bonds	24,000	—	(3,000)	21,000
Tax-exempt components	72,160	—	—	72,160
Inverse rate bonds	79,360	—	—	79,360
Subtotal	12,212,809	1,065,390	(272,113)	13,006,086
Unamortized premium	243,449	21,233	(24,527)	240,155
Deferred charges arising from debt refunding	(261,406)	—	49,336	(212,070)
Savings bonds	231	—		231
Total	$ 12,195,083	1,086,623	(247,304)	13,034,402

Maturities of general obligations and of revenue bonds payable, including accrued interest of capital appreciation bonds, are as follows (expressed in thousands):

		Principal		Interest	Total
Year ending June 30:					
2008	$	318,380		611,882	930,262
2009		326,531		652,449	978,980
2010		384,080		606,611	990,691
2011		403,700		585,890	989,590
2012		415,544		578,730	994,274
2013 – 2017		2,256,133		2,584,324	4,840,457
2018 – 2022		2,725,407		1,977,416	4,702,823
2023 – 2027		2,313,699		1,330,936	3,644,635
2028 – 2032		2,103,071		812,700	2,915,771
2033 – 2037		1,303,661		292,228	1,595,889
2038 – 2042		256,362		81,782	338,144
2043 – 2047		37,164		4,578	41,742
Total		12,843,732	$	10,119,526	22,963,258
Plus accreted discount		162,585			
Plus unamortized premium		240,155			
Less deferred charges arising from debt refunding		(212,070)			
Total	$	13,034,402			

(d) Commonwealth Appropriation Bonds

Over the years, GDB, as fiscal agent and bank for the Commonwealth, had extended lines of credit, advances, and loans to several agencies and component units in order to finance their capital improvement projects and to cover their operational deficits at the time. At different points in time, these loans were refunded through the issuance of Commonwealth appropriation bonds issued by the Puerto Rico Public Finance Corporation (PFC), a blended component unit of GDB. PFC is the financing arm of GDB, which serves only as a conduit for the issuance of the bonds.

During June 2004, PFC advance refunded through the PFC 2004 Series A and B and PFC 2003 Series A through C Refunding Commonwealth Appropriation Bonds, a portion of certain of its outstanding Commonwealth Appropriation Bonds issued in prior years (except for the Health Facilities and Services Administration bonds described below, where no portion was refunded). The Commonwealth recognized a mirror effect of this advance refunding by PFC in its own debt in proportion to the portion of the Commonwealth's notes included in the PFC refunding. As a result, the Commonwealth considered defeased and, therefore, removed from the balance sheet the portion refunded of $775.7 million. The repayment source for these bonds (both the refunding and unrefunded portions) consisted until June 30, 2006 of Commonwealth appropriations submitted for approval of the Legislature annually during the budget preparation process of the Commonwealth.

During July 2006, the source for the 2007 debt service of these appropriation bonds came from PFC instead (not from legislative appropriations), through an advance of approximately $303 million. PFC will get its advance repaid by COFINA, a discretely presented component unit created in 2007 with the capacity to issue bonds to repay or refinance the advance from PFC, the appropriation bonds, the Qualified Zone Academic Bonds (QZAB) bonds and other debt obligations to GDB, collectively referred as the extra-constitutional debt. The COFINA debt in turn will be serviced with the revenues generated from the collection of the first 1% of the sales and use tax, which came in effect on November 15, 2006 (note 3(c)).

The outstanding balance of the Commonwealth appropriation bonds (both the refunding and unrefunded portion combined) comprises the following obligations (expressed in thousands):

Act No. 164 restructuring	$	1,458,343
Health Facilities and Services Administration		410,701
Office for the Improvement of Public Schools of Puerto Rico		319,272
Puerto Rico Maritime Shipping Authority		280,157
Property tax settlement		94,919
Total Commonwealth appropriation bonds	$	2,563,392

On December 17, 2001, Act No. 164 was approved, which authorized certain government agencies and discretely presented component units to refund approximately $2.4 billion of their outstanding obligations with GDB, for which no repayment source existed, over a period not exceeding 30 years, and to be repaid with annual Commonwealth appropriations not to exceed $225 million. This refunding was done with Commonwealth appropriation bonds through several series issued by PFC during the period between December 2001 and June 2002.

Approximately $1.5 billion of the aforementioned outstanding obligations belonged to the primary government, predominantly the Department of Health of the Commonwealth (health reform financing and other costs for approximately $1.1 billion) and the Department of the Treasury of the Commonwealth (the fiscal year 2001 deficit financing of $268 million and the obligation assumed for defective tax liens in the amount of approximately $132 million). The new combined bonds balance of the Act No. 164 restructuring bears interest at rates ranging from 1.25% to 5.80%. Debt service requirements in future years are as follows (expressed in thousands):

	Principal	Interest	Total
Year ending June 30:			
2008	$ 35,076	81,944	117,020
2009	37,031	79,997	117,028
2010	34,707	80,860	115,567
2011	35,799	77,198	112,997
2012	38,506	75,288	113,794
2013-2017	245,683	332,521	578,204
2015-2022	332,797	241,162	573,959
2023-2027	369,396	117,145	486,541
2028-2031	348,769	28,913	377,682
Total	1,477,764	$ 1,115,028	2,592,792
Plus unamortized premium	21,611		
Less deferred charges arising from debt refunding	(41,032)		
Total	$ 1,458,343		

As of July 1, 1999, approximately $595 million (including unpaid interest) of a promissory note of the Health Facilities and Services Administration (HFSA) due to GDB was transferred to the Department of Health of the Commonwealth and restructured through Commonwealth appropriation bonds. The bonds bear interest at rates ranging between 5.90% and 6.20%. Principal and interest on the bonds are payable solely from legislative appropriations to be made pursuant to Act No. 223 of August 9, 1998. The act provides that OMB shall include in the annual budget of the Commonwealth an amount equal to $56.5 million for the fiscal year 1998-99, and for the next succeeding 15 fiscal years the amount necessary to pay the principal of and interest on the bonds, up to a maximum annual amount of $57.7 million. As of June 30, 2007, approximately $411 million was still outstanding.

Debt service requirements in future years are as follows (expressed in thousands):

		Principal	Interest	Total
Year ending June 30:				
2008	$	39,600	18,074	57,674
2009		42,125	15,555	57,680
2010		44,865	12,821	57,686
2011		25,018	32,714	57,732
2012		31,200	26,496	57,696
2013 – 2017		208,915	76,540	285,455
2018		18,978	38,732	57,710
Total	$	410,701	220,932	631,633

Previous public schools infrastructure improvement loans provided additional funds for major repairs and improvements to the public schools in Puerto Rico. This activity is administered by the Office for the Improvement of the Public Schools of Puerto Rico (OIPS), included as part of the general fund of the primary government. These loans were refunded originally through the issuance of Commonwealth appropriation bonds pursuant to Act No. 85 of June 13, 1998 (Act 85). The new combined bonds bear interest at rates ranging from 5.00% to 5.85%. As of June 30, 2007, approximately $319 million was outstanding.

Debt service requirements in future years are as follows (expressed in thousands):

		Principal		Interest	Total
Year ending June 30:					
2008	$	9,945		17,648	27,593
2009		10,465		17,125	27,590
2010		10,990		16,602	27,592
2011		11,580		16,011	27,591
2012		12,200		15,555	27,755
2013 – 2017		77,675		58,674	136,349
2018 – 2022		87,950		37,807	125,757
2023 – 2026		105,880		11,816	117,696
Total		326,685	$	191,238	517,923
Plus unamortized premium		5,941			
Less deferred charges arising from debt refunding		(13,354)			
Total	$	319,272			

A promissory note payable owed by PRMSA to GDB was assumed by the Commonwealth in connection with the sale of the maritime operations of PRMSA. Commonwealth appropriation bonds were issued to refund this liability. The new combined bonds balance bears interest at a variable rate ranging from 3.00% to 7.30%. Debt service requirements in future years are as follows (expressed in thousands):

		Principal		Interest	Total
Year ending June 30:					
2008	$	—		16,907	16,907
2009		—		16,907	16,907
2010		3,415		16,793	20,208
2011		9,390		16,443	25,833
2012		7,280		16,132	23,412
2013 – 2017		67,375		71,494	138,869
2018 – 2022		85,810		51,852	137,662
2023 – 2027		107,240		26,353	133,593
2028 – 2030		47,985		2,248	50,233
Total		328,495	$	235,129	563,624
Less unamortized discount		(599)			
Less deferred charges arising from debt refunding		(47,739)			
Total	$	280,157			

During fiscal year 1996, the Commonwealth refinanced the liability for the settlement of the property taxes owed to the municipalities of Puerto Rico. Commonwealth appropriation bonds were issued to refund this liability. The new combined bonds balance bears interest at rates ranging from 5.87% to 7.25%. Debt service requirements in future years are as follows (expressed in thousands):

		Principal		Interest	Total
Year ending June 30:					
2008	$	15,350		3,040	18,390
2009		16,505		1,885	18,390
2010		31,563		5,225	36,788
2011		13,001		5,389	18,390
2012		12,184		6,211	18,395
2013 – 2016		22,247		14,553	36,800
Total		110,850	$	36,303	147,153
Plus accreted discount		8,962			
Less deferred charges arising from debt refunding		(24,893)			
Total	$	94,919			

(e) Qualified Zone Academy Bonds

During November 2001, the Department of Education of the Commonwealth issued a certification whereby certain Commonwealth public schools were designated as a "qualified zone academy" pursuant to Section 1397E of the U.S. Internal Revenue Code of 1986, as amended. On May 18, 2004, PFC, a blended component unit of GDB, issued $47.9 million of Qualified Zone Academic Bonds (QZAB) to finance expenditures of the Department of Education of the Commonwealth under the aforementioned program, including rehabilitation and repairs of school buildings and other facilities, the development and implementation of academic curricula, technology training for some schools, and the costs of issuance of the bonds. This May 2004 QZAB is payable upon its maturity on May 2020, since the U.S. government grants tax exemptions to bond holders in lieu of an interest rate.

During January 2006, another QZAB in the amount of $39.4 million was issued for similar purposes. The January 2006 QZAB is payable upon its maturity in January 2022.

Also during January 2006, the Commonwealth unwound the 2001 defeasance of the QZAB issued in December 2001, therefore, reverting back the transaction and recognizing in the statement of net assets for the governmental activities such QZAB obligation in the amount of $96.8 million.

During fiscal year 2007 annual appropriations of $12.4 million for the future settlement of the QZABs were not provided by the general fund as it was originally intended. Instead, annual required escrow deposits were funded with monies borrowed by PFC. These advances from PFC would be repaid by COFINA under the same mechanism fully described in note 14 (d).

(f) Notes Payable to Component Units

The Commonwealth has entered into various interim line-of-credit agreements with GDB consisting of the following at June 30, 2007 (expressed in thousands):

Agency	Purpose	Interest rate		Line of credit	Outstanding balance
Department of the Treasury	Resources to meet appropriations in annual budget of the Commonwealth (fiscal year 2004) and Federal program expenditures	125bp over three-month LIBOR	$	640,000	156,744
Public Buildings Authority	Interim construction activities	150bp over GDB's commercial paper rate		256,000	129,112
Department of Transportation and Public Works	Construction and repavement of roads	150bp over GDB's commercial paper rate		15,000	11,604
Department of Recreation and Sports	Recreational projects at various municipalities	150bp over GDB's commercial paper rate		16,000	1,615
			$	927,000	299,075

The Commonwealth financed certain other long-term liabilities through GDB and other component units. The outstanding balance on the financing provided by GDB comprises the following (expressed in thousands), all within governmental activities:

GDB:

Department of the Treasury	$	2,173,659
Department of Health		301,101
Department of Education		124,539
Public Buildings Authority		75,000
Office of Management and Budget		74,772
Department of Transportation and Public Works		68,640
Department of Agriculture		61,173
Department of Justice		49,176
The Children's Trust		42,000
Puerto Rico Court Administration Office		35,092
Police Department		23,143
Department of Recreation and Sports		22,755
Public Housing Administration		21,847
Department of Housing		16,688
Correction Administration		11,892
Office of the Superintendent of the Capitol		9,885
Administration for the Care and Development of the Childhood		5,257
Department of Natural and Environmental Resources		3,056
State Office for the Historic Conservation		2,252
Office of Veterans' Affairs		1,135
Notes payable to GDB	$	3,123,062

Other Components Unit:

Health facilities agreement payable to the Medical Science Campus of UPR	$	63,785
Note payable to PREPA		43,081
Notes payable to other component units	$	106,866

As of June 30, 2007, the Department of the Treasury of the Commonwealth has entered into various line-of-credit agreements with GDB amounting to a maximum of $2.4 billion for different purposes as presented in the following tables. The purpose, interest rate, maturity date, and amount outstanding under each individual agreement at June 30, 2007 consist of the following (expressed in thousands):

Purpose	Interest rate	Maturity	Line of credit	Outstanding balance
To finance payroll and operational expenditures of the Commonwealth for fiscal year 2006	5.50%	June 30, 2036	$ 741,000	741,000
To provide additional resources to meet the appropriations in the annual budget of the Commonwealth for fiscal year 2005	125 bp over three-month LIBOR	June 30, 2014	550,000	550,000
Replenishment of income tax refund reserve for fiscal year 2004	125 bp over three-month LIBOR	June 30, 2008	250,000	238,924
Resources to meet appropriations in annual budget of Commonwealth and partial repayments of TRANS (fiscal year 2004)	125 bp over three-month LIBOR	June 31, 2009	233,000	233,000
Capital improvement projects of agencies and municipalities	150 bp over GDB's commercial paper rate	June 30, 2019	130,000	91,035
Acquisition of safety and security equipment for certain Commonwealth agencies	150 bp over GDB's commercial paper rate	September 30, 2007	105,000	79,832
Resources to cover the operational needs of the catastrophic disasters fund (fiscal year 2004)	125 bp over three-month LIBOR	September 30, 2012	100,000	78,130
Balance brought forward			$ 2,109,000	2,011,921

Purpose	Interest rate	Maturity	Line of credit	Outstanding balance
Balance brought forward			$ 2,109,000	2,011,921
To meet program expenditures of the Puerto Rico Health Insurance Administration and the Department of the Family	125 bp over three-month LIBOR	September 30, 2015	79,930	43,392
To cover deficit in certain elderly and child care programs of the Department of the Family	125 bp over three-month LIBOR	September 30, 2011	30,000	29,928
To fund information technology project	150 bp over GDB's commercial paper rate	June 30, 2008	44,868	14,783
To pay debt with Municipal Revenue Collection Center	125 bp over three-month LIBOR	June 30, 2011	16,241	16,241
Resources to various agencies to pay outstanding debt with PBA	125bp over three-month LIBOR	September 30, 2008	40,000	14,182
To stimulate economy in municipalities of Ceiba and Naguabo	125 bp over three-month LIBOR	September 30, 2012	14,500	12,665
To pay outstanding debt of various agencies with the Puerto Rico Telephone Company	125 bp over three-month LIBOR	September 30, 2008	16,000	12,157
To acquire correctional facilities	125 bp over three-month LIBOR	June 30, 2010	15,000	9,868
Resources to cover the operational needs of the catastrophic disasters fund (fiscal year 2004)	125 bp over three-month LIBOR	July 31, 2007	8,000	5,825
Purchase of mobile X-ray machines	125 bp over three-month LIBOR	June 30, 2008	12,000	2,697
			$ 2,385,539	2,173,659

On November 17, 2006, Act No. 249 was enacted creating the Special Health Fund (SHF), ascribed to the DOH, to cover budgetary deficiencies at the Puerto Rico Health Insurance Administration (PRHIA) in the implementation of the health reform and to finance the needs of the Puerto Rico Medical Services Administration (PRMSA) in the treatment and trauma programs. Act. No. 249 authorized GDB to provide funding to the SHF up to a maximum of $253 million to finance these needs. On December 22, 2006, GDB provided the aforementioned financing, payable in annual installments for a term of six years until 2013, beginning on September 15, 2007, including interest at the rate of 7.50%. The source of the repayment will come from annual contributions from the State Insurance Fund Corporation, which in turn are expected to be funded with future Commonwealth appropriations for the same amounts. As of June 30, 2007, this line of credit amounted to $253 million.

On August 2003, the Department of Health of the Commonwealth entered into a $30 million line-of-credit agreement with GDB in order to repay certain outstanding debts that the PRMSA had with other agencies and suppliers. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon maturity of the line of credit on June 30, 2012. As of June 30, 2007, $28.9 million related to this line-of-credit agreement was outstanding. On November 8, 2004, the Department of Health entered into an additional $58.5 million line-of-credit agreement with GDB for the financing of a project of the Department of Health and PRMSA. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on October 31, 2014. As of June 30, 2007, this line-of-credit agreement amounted to $19.2 million.

On February 6, 2003, the Department of Education of the Commonwealth entered into a $25 million line-of-credit agreement with GDB for the purchase of equipment and for school improvements. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2008. As of June 30, 2007, $9.5 million was outstanding. On August 4, 2002, the Department of Education of the Commonwealth entered into an additional $140 million line-of-credit agreement with GDB in order to reimburse the Department of the Treasury of the Commonwealth for payments made on their behalf for state funds used to fund federal program expenditures. Borrowings under this line of credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2007. As of June 30, 2007, $115 million was outstanding related to the borrowing. The line of credit will be repaid with federal grants. On August 30, 2002, the Department of Education of the Commonwealth also entered into a $2.3 million line-of-credit agreement with GDB for the construction of school facilities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on July 1, 2006. At June 30, 2007, no amounts had been drawn under this line of credit.

On April 6, 2006, the Public Buildings Authority executed a loan agreement with GDB for $75 million bearing interest at a variable rate based on 125 basis points over the three-month London Interbank Offered Rate (LIBOR) index. The loan, obtained for operational needs, is due on June 30, 2010 and is collateralized with two of PBA's properties. At June 30, 2007, $75 million remained outstanding.

On June 5, 2006, the Office of Management and Budget entered into a $150 million line-of-credit agreement with GDB to provide economic assistance for disasters and emergencies. Borrowings under this line-of-credit agreement bear interest at variable rates based on 125 basis points over three-month LIBOR, and are payable upon the maturity of the line of credit on September 30, 2011. As of June 30, 2007, $74.8 million was outstanding.

On March 8, 2004, the Department of Transportation and Public Works (DTPW), entered into a $26 million line-of-credit agreement with GDB for the improvement and maintenance of the roads around the island. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2010. As of June 30, 2007, this line of credit has an outstanding balance of approximately $21.2 million. On November 16, 2004, the DTPW entered into another $33 million line-of-credit agreement with GDB for similar purposes. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on October 31, 2010. As of June 30, 2007, $14.4 million remains outstanding related to these borrowings. On June 23, 2005, the DTPW entered into an additional $44 million line-of-credit agreement with GDB to meet program expenditures. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 2.5% and are payable upon the maturity of the line of credit on September 30, 2008. As of June 30, 2007, this line of credit has an outstanding balance of approximately $33 million. On June 29, 2006, all three mentioned line-of-credit agreements were amended in order to change interest rates, from a variable rate based on 125 basis over GDB's commercial paper to the interest stated above.

On August 9, 1999, the Department of Agriculture of the Commonwealth entered into a $125 million nonrevolving line-of-credit agreement with GDB to provide economic assistance to the agricultural sector, which sustained severe damages caused by Hurricane Georges in 1998. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2014. As of June 30, 2007, $61.2 million remains outstanding.

On October 2, 2002, the Department of Justice of the Commonwealth entered into a $90 million line-of-credit agreement with GDB for the financing of 12 public improvement projects for the Municipality of Ponce pursuant to a court order. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2014. As of June 30, 2007, $21.5 million related to this line-of-credit agreement was outstanding. On July 8, 2005, the Department of Justice of the Commonwealth entered into an additional $63.4 million line-of-credit agreement with GDB for various projects in Ponce. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2014. As of June 30, 2007, this line-of-credit agreement amounted to $27.6 million.

On June 29, 2007, The Trust entered into a loan agreement with GDB to advance the payment of grants to the Department of Health. This loan bears variable interest of 4.15% subject to tax exempt commercial paper. The loan's outstanding balance at June 30, 2007 was $42 million and matures on December 29, 2007. Principal and interest are payable from a future issuance of the tobacco settlement asset-backed bonds.

On May 7, 2001, the Puerto Rico Court Administration Office (the Office) entered into a $49.4 million nonrevolving line-of-credit agreement with GDB for operating purposes. Borrowings under this line-of-credit agreement bear interest at a variable rate of three-month LIBOR plus 1%, not to exceed 8%. The Office must deposit $6 million a year, from the total fees collected on the filing of civil cases, in a special fund created by the Department of the Treasury of the Commonwealth, which is pledged for repayment until July 31, 2015. As of June 30, 2007, approximately $35 million remains outstanding.

On July 29, 2004, the Police Department entered into a $48 million line-of-credit agreement with GDB for the acquisition of vehicles and high technology equipment. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2014. The outstanding balance of this line-of-credit agreement amounted to $23.1 million at June 30, 2007.

On October 23, 2002, the Department of Recreation and Sports of the Commonwealth (DRS) entered into a $17.5 million line-of-credit agreement with GDB for the development of a recreational complex and other facilities in San Juan, which will eventually become the DRS' principal office headquarters. During fiscal year 2007, this line of credit was combined with a May 25, 2006 line of credit issued for an additional $3 million for the development of a series of recreational projects at different municipalities. Borrowings under this combined line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2008. As of June 30, 2007, $13 million was outstanding. On January 18, 2005, the DRS also entered into a $17.2 million line-of-credit agreement with GDB for the development of a series of recreational projects at different municipalities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2010. As of June 30, 2007, $9.7 million was outstanding.

The Public Housing Administration has available a $97.1 million of a line of credit secured by the Department of Housing and Urban Development of the United States of America. It bears interest at the daily weighted average rate of the GDB outstanding commercial paper notes plus a required margin cost (5.67% at June 30, 2006). At June 30, 2007, the outstanding balance under this line of credit was $21.8 million.

On March 8, 2007, the Department of Housing and entered into a $19 million line-of-credit agreement with GDB, to reimburse the Puerto Rico Housing Finance Authority, a blended component unit of GDB for certain advances made for the Santurce Revitalization Program. Borrowings under this line-of-credit agreement bear interest at a variable rate of three-month LIBOR plus 1.25%, not to exceed 4% and are payable upon the maturity of the line of credit on March 15, 2009. It also can be prepaid without any penalty during said term. The line of credit will be repaid from the proceeds on the sale and development of the properties acquired under the Revitalization Program. As of June 30, 2007, the line of credit has an outstanding balance of $16.7 million.

On August 28, 2000, GDB approved an amendment to the terms of two line-of-credit agreements of the Correction Administration by which such debts would be repaid between fiscal years 2000 and 2007. The two agreements were issued by GDB in August 1998 to partially fund permanent improvements to correctional facilities. The agreements have variable interest rates and limits of $60 million and $15 million. These two lines of credits were fully repaid during fiscal year 2007. On May 12, 2004, the Correction Administration entered into an additional $60 million line-of-credit agreement with GDB for improvements to certain correctional facilities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2010. As of June 30, 2007, $11.9 million was outstanding.

On June 21, 2001, the Office of the Superintendent of the Capitol (Superintendent) entered into a $10 million line-of-credit agreement with GDB for the construction of a parking lot. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 8% and are payable from Commonwealth appropriations commencing in fiscal year 2003 through fiscal year 2007. As of June 30, 2007, $2.9 million related to the line-of-credit agreement remained outstanding. On February 15, 2002, the Superintendent entered into an additional $35 million line-of-credit agreement with GDB for the acquisition and remodeling of several buildings under their jurisdiction. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 8% and have been payable through fiscal year 2008. As of June 30, 2007, $6.9 million remained outstanding from the line-of-credit agreement.

On February 24, 2006 the Administration for the Care and Development of the Childhood entered into an $8 million line-of-credit agreement with GDB to provide economic assistance for the summer program known as "Care and Development of the Child Program". Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2009. As of June 30, 2007, $5.3 million was outstanding.

On August 21, 2002, the Department of Natural and Environmental Resources of the Commonwealth entered into a $22.7 million line-of-credit agreement with GDB for the canalization of the Bucana River. Borrowings under this line-of-credit agreement carried interest at variable rates and were fully repaid on its maturity at June 30, 2007. On September 3, 2003, the DNER entered into a $2 million line-of-credit agreement with GDB for the canalization of Guayanilla River. Borrowings under this line-of-credit agreement bear interest at variables rates and are payable upon the maturity of the line of credit on June 30, 2007. As of June 30, 2007, $56 thousands remained outstanding. On August 22, 2005, the DNER entered into an additional $3.5 million line-of-credit agreement with GDB for the canalization of Fajardo River. Borrowings under this line-of-credit agreement bear interest at variables rates and are payable upon the maturity of the line of credit on September 30, 2007. As of June 30, 2007, $3 million was outstanding.

On August 1, 2001, the State Office for the Historic Conservation entered into a $4.5 million line-of-credit agreement with GDB for the construction and conservation of the Santa Catalina Palace and the Real Audience building. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on December 31, 2008. As of June 30, 2007, the outstanding balance of this line-of-credit agreement amounts to $2.3 million.

On October 20, 2004, the Office of Veterans' Affairs entered into a $1.6 million line-of-credit agreement with GDB to provide economic assistance and housing-leasing services to Puerto Rican veterans. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2006. As of June 30, 2007, $1.1 million was outstanding.

As of July 1, 1999, debts of approximately $102 million payable to UPR, a discretely presented component unit, in relation to outstanding noninterest-bearing debt accumulated in prior years by HFSA were transferred to the Commonwealth. On September 7, 2004, additional debts of approximately $71.2 million were also restructured and combined with the previous financing arrangement. As of June 30, 2007, $63.8 million remains outstanding. Future amounts required to pay principal balances at June 30, 2007 are expected to be as follows (expressed in thousands):

Year ending June 30:		
2008	$	23,355
2009		7,570
2010		7,570
2011		7,570
2012		8,000
2013 – 2015		9,720
Total	$	63,785

The noninterest-bearing note payable to PREPA, a discretely presented component unit, consists of $19 million of fuel adjustment subsidy due by the Commonwealth and the refinancing during 2004 of $24.1 million of other accumulated debt by the Commonwealth's agencies with PREPA. Future amounts required to pay principal balances at June 30, 2007 are expected to be as follows (expressed in thousands):

Year ending June 30:		
2008	$	12,654
2009		6,327
2010		24,100
Total	$	43,081

With the exception of a few lines of credit having a defined source of repayment, the remaining lines of credit described above used Commonwealth appropriations as the source of repayment until June 30, 2007. Beginning with fiscal year 2008, these lines of credit are expected to be repaid or refunded with a combination of Commonwealth appropriations and COFINA under the mechanism fully described in note 14(d).

(g) Compensated Absences

Long-term debt includes approximately $1,800 million of accrued vacation and sick leave benefits at June 30, 2007. The total liability of compensated absences recorded as governmental and business-type activities amounted to $1,794 million and $6 million, respectively.

(h) Net Pension Obligation

The amount reported as net pension obligation of approximately $5.1 billion represents the cumulative amount owed by the Commonwealth for the unfunded prior years' actuarially required pension contributions to the ERS and the TRS (collectively known as the pension plans) (see note 19). The net pension obligation has been recorded as a liability in governmental activities in the accompanying statement of net assets.

(i) Unpaid Lottery Prizes

The amount reported as unpaid lottery prizes represents the lottery prizes payable of the Lottery of Puerto Rico (commonly known as Traditional Lottery) and the Additional Lottery System (commonly known as Lotto) jointly known as the Lottery Systems at June 30, 2007. The minimum annual payments related to unpaid awards of both lotteries are as follows (expressed in thousands):

		Principal	Interest	Total
Year(s) ending June 30:				
2008	$	55,377	3,489	58,866
2009		31,547	5,151	36,698
2010		29,968	6,730	36,698
2011		28,468	8,230	36,698
2012		24,836	8,856	33,692
2013 – 2017		81,959	45,841	127,800
2018 – 2022		32,844	32,307	65,151
2023 – 2026		7,291	10,211	17,502
Total	$	292,290	120,815	413,105

The liability for unpaid lottery prizes is reported in the accompanying statement of net assets and the statement of net assets – business-type activities – proprietary funds.

(j) Claims Liability for Insurance Benefits

The Commonwealth provides unemployment compensation, nonoccupational disability, and drivers' insurance coverage to public and private employees through various insurance programs administered by the Department of Labor and Human Resources of the Commonwealth. These insurance programs cover workers against unemployment, temporary disability, or death because of work- or employment-related accidents or because of illness suffered as a consequence of their employment.

The Commonwealth establishes liabilities for incurred but unpaid benefits and benefit adjustment expenses based on the ultimate cost of settling the benefits. Insurance benefit claim liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. The liability for insurance benefits claims is reported as a current liability in the accompanying statement of net assets and the statement of net assets – business-type activities – proprietary funds.

(k) Obligations under Capital Lease Arrangements

The Commonwealth is obligated under capital leases with third parties that expire through 2034 for land, buildings, and equipment. At June 30, 2007, the capitalized cost of the land, buildings, and equipment amounted to approximately $167 million and is included in the accompanying government-wide statement of net assets within capital assets.

The present value of future minimum capital lease payments at June 30, 2007 reported in the accompanying government-wide statement of net assets is as follows (expressed in thousands):

Year(s) ending June 30:		
2008	$	15,818
2009		14,811
2010		14,569
2011		14,258
2012		13,886
2013 – 2017		66,943
2018 – 2022		57,883
2023 – 2027		56,934
2028 – 2032		46,252
2033 – 2037		1,708
Total future minimum lease payments		303,062
Less amount representing interest costs		(161,251)
Present value of minimum lease payments	$	141,811

Leased land, buildings, and equipment under capital leases in capital assets at June 30, 2007, include the following (expressed in thousands):

Land	$	7,960
Buildings		146,202
Equipment		12,401
Subtotal		166,563
Less accumulated amortization		(28,661)
Total	$	137,902

Amortization charge applicable to capital leases and included within depreciation expense of capital assets amounted to approximately $5 million in 2007.

The Commonwealth is also committed under numerous operating leases, covering land, office facilities, and equipment. Rental expenditures within the governmental funds for the year ended June 30, 2007 under such operating leases were approximately $148 million.

The future minimum lease payments for these leases are as follows (expressed in thousands):

Year(s) ending June 30:		
2008	$	108,166
2009		83,547
2010		55,698
2011		41,444
2012		29,183
2013 – 2017		64,943
2018 – 2022		4,957
2023 – 2027		2,013
Total future minimum lease payments	$	389,951

(l) Other Long-Term Liabilities

The remaining long-term liabilities of governmental activities at June 30, 2007 include (expressed in thousands):

Employees' Christmas bonus	$	100,074
Liability for federal cost disallowances		50,159
Liability for legal claims and judgments (note 18)		950,276
Liability to U.S. Army Corps of Engineers (note 12)		205,000
Total	$	1,305,509

As described in note 12, the Commonwealth has a debt obligation with the U.S. Army Corps of Engineers in relation to the construction of the Cerrillos Dam and Reservoir project and the Portugues river and the Bucana river projects.

(m) Advance Refunding, Defeased Bonds, and Refunding of Special Promissory Notes

In prior years, the Commonwealth defeased certain general obligation and other bonds by placing the proceeds of the bonds in an irrevocable trust to provide for all future debt service payments on the refunded bonds. Accordingly, the trust's account assets and liabilities for the defeased bonds are not included in the basic financial statements. At June 30, 2007, approximately $1.5 billion of bonds outstanding from prior years advance refunding are considered defeased.

In addition, PBA, a blended component unit, has defeased certain revenue bonds in prior years by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old debts. Accordingly, the trust's account assets and liabilities for the defeased bonds are not included in the statement of net assets. As of June 30, 2007, approximately $655 million of PBA bonds are considered defeased.

(Continued)

Fiduciary Funds

On June 29, 2006, the ERS entered into a credit agreement with a financial institution in which loans could be made from time to time in the aggregate principal amount not exceeding $112 million. The outstanding balance of $60 million at June 30, 2006 was fully repaid during fiscal year 2007.

On August 1, 1996, the TRS entered into a loan agreement with AFICA, a discretely presented component unit, to secure AFICA's issuance of $26.9 million of industrial revenue term bonds. The bonds were issued under a trust agreement and are secured by a pledge of certain marketable securities of the TRS. The proceeds from the sale of the bonds were lent by AFICA to TRS to finance the acquisition of certain buildings and related facilities and to pay certain expenses incurred in connection with the issuance and sale of the bonds.

On March 15, 2007, the bonds were paid in full from the TRS assets and from the TRS account with the trustee. Once the bonds were paid in full, the pledged collateral was released and contributed to TRS investment portfolio. The following is a summary of changes in the bonds payable principal balance (expressed in thousands):

	Balance June 30, 2006	Additions	Deductions	Balance June 30, 2007
6.65% Term Bonds Series A due July 1, 2011	$ 5,220	—	5,220	—
5.50% Term Bonds Series B due July 1, 2016	6,575	—	6,575	—
5.50% Term Bonds Series B due July 1, 2021	8,635	—	8,635	—
Total	$ 20,430	—	20,430	—

Discretely Presented Component Units

Notes and bonds payable are those liabilities that are paid out of the component units' own resources. These notes and bonds do not constitute a liability or debt of the Commonwealth.

The outstanding balance of notes payable at June 30, 2007 is as follows (expressed in thousands):

Component unit	Interest rate	Maturity through	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Government Development Bank for Puerto Rico	4.1% – 7.5%	2031	$ 2,734,957	2,440,380	2,895,424	2,279,913	692,846
Puerto Rico Electric Power Authority	2.60% – 5.47%	2012	411,835	452,850	9,624	855,061	387,277
State Insurance Fund Corporation	Discounted notes from 6.31% to 6.84%	2019	53,592	—	1,956	51,636	2,278
Economic Development Bank for Puerto Rico	4.18% – 5.22%	2025	500,000	—	—	500,000	—
Puerto Rico Industrial Development Company	5.00% – 6.73%	2025	68,319	31,705	3,543	96,481	4,382
Land Authority of Puerto Rico	4.87	2010	8,483	—	2,121	6,362	2,121
Puerto Rico Ports Authority	Variable	2028	134,949	446,305	30,353	550,901	127,091
Agricultural and Services Development Administration	Variable	2007	10,238	—	405	9,833	9,833
Puerto Rico Trade & Export Company	5.20% – 6.20%	2026	400,000	50,000	200,000	250,000	—
Puerto Rico Aqueduct and Sewer Authority	6.51%	2012	—	250,000	—	250,000	—
Puerto Rico Metropolitan Bus Authority	Variable	2012	—	46,000	430	45,570	4,720
Total notes payable – component units			$ 4,322,373	3,717,240	3,143,856	4,895,757	1,230,548

Debt service requirements on component units' notes payable with fixed maturities at June 30, 2007 were as follows (expressed in thousands):

	Principal	Interest	Total
Year(s) ending June 30:			
2008	$ 1,230,548	220,642	1,451,190
2009	147,064	200,717	347,781
2010	485,696	176,220	661,916
2011	91,900	164,235	256,135
2012	406,052	147,184	553,236
2013 – 2017	524,439	591,249	1,115,688
2018 – 2022	440,161	514,802	954,963
2023 – 2027	649,640	355,464	1,005,104
2028 – 2032	920,170	196,918	1,117,088
Premium, net	87	—	87
Total	$ 4,895,757	2,567,431	7,463,188

Commonwealth appropriation bonds payable outstanding at June 30, 2007 are as follows (expressed in thousands):

Component unit	Interest rate	Maturity through		Beginning balance	Additions	Reductions	Ending balance	Due within one year
Puerto Rico Aqueduct and Sewer Authority	4% – 6.15%	2031	$	1,072,286	8,189	9,307	1,071,168	18,409
Puerto Rico Tourism Company	4% – 6.15%	2031		126,527	—	409	126,118	1,916
Land Authority of Puerto Rico	4% – 6.15%	2031		163,335	—	719	162,616	613
Government Development Bank for Puerto Rico	4% – 6.15%	2031		10,244	—	45	10,199	39
Puerto Rico Infrastructure Financing Authority	7.50%	2031		10,553	—	46	10,507	40
Puerto Rico Solid Waste Authority	1.25% – 5.75%	2031		7,701	—	—	7,701	—
Total appropriation bonds – component units			$	1,390,646	8,189	10,526	1,388,309	21,017

Debt service requirements on component units' appropriation bonds payable with fixed maturities at June 30, 2007 were as follows (expressed in thousands):

		Principal	Interest	Total
Year(s) ending June 30:				
2008	$	21,017	77,173	98,190
2009		23,976	76,130	100,106
2010		23,767	74,956	98,723
2011		22,115	75,388	97,503
2012		23,122	75,098	98,220
2013 – 2017		158,582	293,377	451,959
2018 – 2022		230,333	235,291	465,624
2023 – 2027		340,806	165,566	506,372
2028 – 2032		566,016	51,577	617,593
Premium		44,441	—	44,441
Deferred loss, net		(65,866)	—	(65,866)
Total	$	1,388,309	1,124,556	2,512,865

Bonds payable outstanding at June 30, 2007 are as follows (expressed in thousands):

Component unit	Interest rate	Maturity through	Beginning balance (as restated)	Additions	Reductions	Ending balance	Amounts due within one year
Government Development for Puerto Rico	Variable	2038	$ 1,380,097	150,664	247,507	1,283,254	70,698
Puerto Rico Infrastructure Financing Authority	Variable	2046	2,582,257	547,899	32,553	3,097,603	32,225
University of Puerto Rico	3% – 5.75%	2030	466,186	575,494	303,828	737,852	22,790
Puerto Rico Municipal Finance Authority	3.50% – 8.62%	2031	1,616,565	—	118,622	1,497,943	99,035
Puerto Rico Ports Authority	5.00% – 7.30%	2021	66,204	205	4,545	61,864	4,855
Puerto Rico Aqueduct and Sewer Authority	3.5% – 8.22%	2044	463,840	850,000	17,187	1,296,653	19,989
Puerto Rico Highways and Transportation Authority	2.25% – 6.50%	2046	6,641,212	2,712,362	2,348,324	7,005,250	66,020
Puerto Rico Industrial Development Company	1.50% – 6.71%	2029	289,972	1,621	10,458	281,135	6,992
Puerto Rico Convention Center District Authority	4.00% – 5.00%	2037	482,589	—	867	481,722	3,000
Puerto Rico Electric Power Authority	3.00% – 7.00%	2037	5,156,530	2,531,369	2,040,190	5,647,709	361,694
Total bonds – component units			$ 19,145,452	7,369,614	5,124,081	21,390,985	687,298

Debt service requirements on component units' bonds payable with fixed maturities at June 30, 2007 were as follows (expressed in thousands):

	Principal	Interest	Total
Year(s) ending June 30:			
2008	$ 687,298	1,083,444	1,770,742
2009	1,362,174	932,497	2,294,671
2010	735,553	900,659	1,636,212
2011	548,535	869,198	1,417,733
2012	566,206	843,151	1,409,357
2013 – 2017	3,695,113	3,733,004	7,428,117
2018 – 2022	3,307,507	2,909,528	6,217,035
2023 – 2027	3,442,964	2,150,737	5,593,701
2028 – 2032	2,634,643	1,844,306	4,478,949
2033 – 2037	2,224,897	1,088,022	3,312,919
2038 – 2042	1,846,833	403,480	2,250,313
2043 – 2046	676,224	332,506	1,008,730
Discount, net	(336,962)	—	(336,962)
Total	$ 21,390,985	17,090,532	38,481,517

(Continued)

Several component units have defeased certain revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old debts. Accordingly, the trust accounts' assets and liabilities for the defeased bonds are not included in the statement of net assets. As of June 30, 2007, the following bonds are considered defeased:

	Amount outstanding (In millions)
Puerto Rico Electric Power Authority	$ 3,224
Puerto Rico Highways and Transportation Authority	3,169
Puerto Rico Infrastructure Financing Authority	699
Puerto Rico Municipal Finance Agency	300
	$ 7,392

(15) Guaranteed and Appropriation Debt

(a) Guaranteed Debt

The Commonwealth may provide guarantees for the repayment of certain borrowings of component units to carry out designated projects. At June 30, 2007, the following component unit debts are guaranteed by the Commonwealth (expressed in thousands):

	Maximum guarantee	Outstanding balance
Blended component unit:		
Public Buildings Authority	$ 3,325,000	2,789,927
Discretely presented component units:		
Puerto Rico Aqueduct and Sewer Authority	838,623	716,158
Port of the Americas Authority (a component unit of Puerto Rico Infrastructure Financing Authority)	250,000	87,390
Government Development Bank for Puerto Rico	342,000	267,000
Total	$ 4,755,623	3,860,475

The Commonwealth has guaranteed the payments of rentals of its departments, agencies, and component units to PBA, a blended component unit, under various lease agreements executed pursuant to the law that created PBA. Such rental payments include the amounts required by PBA for the payment of principal and interest on the guaranteed debt as authorized by law. The rental commitment to cover principal and interest on the guaranteed debt (excluding premiums and deferred refunding losses) as of June 30, 2007 and for the next five years and thereafter follows (expressed in thousands):

	Principal	Interest	Total
Year(s) ending June 30:			
2008	$ 75,690	138,934	214,624
2009	80,684	134,992	215,676
2010	86,740	128,120	214,860
2011	89,455	123,273	212,728
2012	85,802	132,313	218,115
2013 – 2017	396,795	560,261	957,056
2018 – 2022	380,545	449,027	829,572
2023 – 2027	433,080	353,042	786,122
2028 – 2032	507,369	275,211	782,580
2033 – 2037	694,105	86,674	780,779
	2,830,265	2,381,847	$ 5,212,112
Add (deduct) accreted discount	29,277	(29,277)	
Unamortized premiums, discounts, and deferred losses, net	(69,615)	—	
	$ 2,789,927	2,352,570	

Rental income of PBA funds amounted to approximately $290 million during the year ended June 30, 2007, of which $214 million was used to cover debt service obligations.

Act No. 45 of July 28, 1994 states that the Commonwealth guarantees the payment of principal and interest of all outstanding bonds at the date the law was enacted and of all future bond issues to refinance those outstanding bonds of PRASA. During December 1995, PRASA issued refunding bonds to refinance all outstanding bonds amounting to approximately $400 million. The outstanding balance of these refunding bonds at June 30, 2007 amounted to $277.8 million. Act No. 140 of August 3, 2000 amended Act No. 45 to extend the commonwealth guarantee to include the principal and interest payments of the Rural Development Serial Bonds and the loans under the State Revolving Fund Program (SRFP) outstanding at the effective date of Act No. 140, and of all future bonds and SRFP loans that may be issued until June 30, 2005. Act No. 386 of September 21, 2004 extended the commonwealth guarantee to June 30, 2010. The outstanding balance of the Rural Development Serial Bonds and SRFP loans at June 30, 2007 amounted to $209.2 million and $229.2 million, respectively.

The Commonwealth guarantees the Adjustable Refunding Bonds, Series 1985, issued by GDB, a discretely presented component unit. The outstanding balance of these bonds amounts to $267 million at June 30, 2007. The Puerto Rico Housing Bank, a former component unit of the Commonwealth, which merged with and into GDB during 2002, insured mortgages granted to low- and moderate-income families through its mortgage loan insurance program. The Commonwealth guarantees up to $75 million of such mortgage loans. As of June 30, 2007, the mortgage loan insurance program was insuring loans aggregating $203 million. Currently, the Commonwealth has not been called to make any direct payments pursuant to these guarantees.

At various times during fiscal years ended 2005 and 2006, the Port of the Americas Authority, currently a component unit of the Puerto Rico Infrastructure Financing Authority, entered into bond purchase agreements with GDB, whereby GDB agreed to disburse to the Port of the Americas Authority from time to time certain bond principal advances up to a maximum aggregate principal amount of $70 million (Port of the Americas Authority 2005 Series A Bond), $40 million (Port of the Americas Authority 2005 Series B Bond), and $140 million (Port of the Americas Authority 2005 Series C Bond). The proceeds of the bonds are to be used to finance the cost of development and construction of the Port of the Americas. The aggregate unpaid principal balance of all outstanding bond principal advances shall be payable in full on January 1, 2015. The principal amount may be paid with any of the following: a long-term bond issuance once the projects are completed, other revenue of the Port of the Americas Authority or legislative appropriations as established in Act 409 of September 22, 2004 (Act No. 409). Principal and interests payments are guaranteed by the Commonwealth by Act No. 409. As of June 30, 2007, the principal outstanding under those bond purchase agreements amounted to $87.4 million.

(b) Appropriation Debt

At June 30, 2007, the outstanding balances of debt payable by Commonwealth appropriations or sales and use tax revenue through COFINA, as described in note 14(d), which are included in the individual financial statements of the following discretely presented component units, are as follows (expressed in thousands):

Puerto Rico Aqueduct and Sewer Authority	$	1,071,168
Special Communities Perpetual Trust		385,152
Puerto Rico Public Finance Corporation (a blended component unit of GDB)		302,265
Land Authority of Puerto Rico		162,616
Puerto Rico Convention Center District Authority		155,221
Puerto Rico Tourism Company		126,118
Puerto Rico Solid Waste Authority		74,500
Agricultural Services and Development Administration		62,578
Puerto Rico Industrial Development Company		43,403
Puerto Rico Electric Power Authority		39,718
Puerto Rico Housing Finance Authority (a blended component unit of GDB)		25,564
Institute of Puerto Rican Culture		22,755
University of Puerto Rico		20,288
Puerto Rico Infrastructure Financing Authority		10,507
National Parks Company of Puerto Rico		3,830
Other governmental entities		31,128
Total	$	2,536,811

These balances are reported in the statement of net assets as Commonwealth appropriation bonds payable and notes payable.

(16) Conduit Debt Obligations and No-Commitment Debt

From time to time, certain of the Commonwealth's component units issue revenue bonds to provide financial assistance to private-sector entities for the acquisition and construction of transportation, environmental, industrial, tourism, educational, and commercial facilities, deemed to be in the public interest and that are expected to provide benefits to Puerto Rico. These bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Upon repayment of the bonds, ownership of the acquired facilities is retained by the private-sector entity served by the bond issuance. Neither the Commonwealth nor any political subdivision or component unit thereof is obligated in any manner for the repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the basic financial statements of the issuing entities. As of June 30, 2007, conduit debt obligations consisted of the following bonds issued by component units (expressed in thousands):

Issuing entity		Issued since inception to date	Amount outstanding
Discretely presented component units:			
Puerto Rico Ports Authority	$	155,410	155,410
Puerto Rico Highways and Transportation Authority		270,000	157,024
Government Development Bank for Puerto Rico		663,000	619,000
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority		5,973,000	1,582,000

(a) Puerto Rico Ports Authority (PRPA)

PRPA issued Special Facilities Revenue Bonds under the provisions of two trust agreements between PRPA and a private bank. The proceeds from the sale of the bonds were used to finance the construction, acquisition of equipment, and improvement of certain facilities at Luis Munoz Marin International Airport, for the benefit of a major private airline. The property is owned by PRPA and leased to the private company. Pursuant to the agreements between PRPA and the private company, the bonds will be paid from the rent collected from the airline in amounts sufficient to pay principal, premium (if any), and interest on the bonds. The airline has guaranteed these payments.

(b) Puerto Rico Highways and Transportation Authority (PRHTA)

In March 1992, PRHTA issued Special Facility Revenue Bonds for approximately $117 million for the construction of a toll bridge. The proceeds from the sale of these bonds were transferred by PRHTA to a private entity, Autopistas de Puerto Rico (Autopistas), pursuant to a signed agreement for the construction, transfer, and operation of the bridge. On October 2003, PRHTA issued Special Facility Revenue Refunding Bonds, 2004 Series A, amounting to approximately $153 million for the purpose of refunding the Authority's Special Facility Revenue Bonds, 1992 Series A, B, and C, which were issued to fund the construction of the bridge, and to pay the cost of issuance of the bonds. The bonds shall be paid from the proceeds received by Autopistas from the operation of the bridge.

Under certain circumstances, the concession agreement may be terminated and the authority is then obligated to assume the Autopista's entire obligation to pay principal of and interest, which pursuant to the signed agreement, will be paid from the net revenues of the use and operation of the bridge. The authority does not currently expect the concession agreement to terminate. The outstanding bonds (including accrued interest) at June 30, 2007 amounted to approximately $157 million.

(c) GDB

GDB, through its Housing Finance Authority, issued $663 million in Capital Fund Program Bonds Series 2003 to fund PHA in its financing of improvements to various public low- and moderate-income housing projects. Certain of the obligations issued are considered no-commitment debt and are excluded, along with the related assets held in trust, from the accompanying basic financial statements. These bonds are limited obligations of the Housing Finance Authority, which will be paid solely from an annual allocation of public housing capital funds when received from the U.S. Department of Housing and Urban Development; accordingly, these bonds are considered no-commitment debt. The outstanding balance of these bonds amounted to $619 million at June 30, 2007.

(d) AFICA

The revenue bonds of AFICA are used to finance facilities for environmental control, development of industrial and commercial companies, tourism projects, hospitals, and educational facilities. Pursuant to the loan agreements, the proceeds from the sales were borrowed by corporations and partnerships operating in Puerto Rico. The bonds are limited obligations of AFICA and, except to the extent payable from bond proceeds and investment thereof, will be payable solely from and secured by a pledge and assignment of the amounts payable under the loan agreements between AFICA and each borrower. Furthermore, payment of the principal and interest on the revenue bonds is unconditionally guaranteed by each of the borrowers, their parent companies, or letters of credit from major U.S. banks or U.S. branches of international banks.

(17) Risk Management

The risk management program of the Commonwealth and most of its discretely component units are described in note 1(y). The following describes the risk management programs separately administered by certain discretely presented component units:

(a) UPR

UPR is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Through January 1993, UPR was insured under claims-made insurance policies with respect to medical malpractice risks for $250,000 per occurrence up to an annual aggregate of $500,000. Subsequent to such date, UPR was unable to obtain insurance at a cost it considered to be economically justifiable; consequently, UPR is now self-insured for such risks. Under Act No. 98 of August 24, 1994, the responsibility of UPR is limited to a maximum amount of $75,000 per person, or $150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Self-insured risk liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend upon such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. Changes in the claims liability amount in fiscal years 2007 and 2006 were as follows (expressed in thousands):

		2007	2006
Claims payable – July 1	$	18,332	20,260
Incurred claims and changes in estimates		34,279	27,378
Payments for claims and adjustments expenses		(30,551)	(29,306)
Claims payable – June 30	$	22,060	18,332

UPR continues to carry commercial insurance for all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

(b) PREPA

PREPA is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The PREPA obtains insurance policies covering all-risk property (excluding transmission and distribution lines), boiler and machinery, and public liability. The all-risk property and boiler and machinery policies have a combined coverage of $650 million per occurrence. The policies' self-retention in case of earthquake and windstorm losses is $25 million and $2 million for all other covered risks. The public general liability policy covers property damage and bodily injury to third parties with a $75 million aggregate limit in excess of the self-retention limit of $1 million per occurrence.

PREPA has a cost plus health insurance program covering substantially all employees. PREPA contracted an administrator for the processing, approval, and payment of claims plus an administrative fee. The accrual for employees' health plan includes the liability for claims processed and an estimate for claims incurred but not reported.

In addition, PREPA is self-insured for its transmission and distribution lines. Transmission and distribution lines amounted to approximately $3.6 billion at June 30, 2007. PREPA's self-insurance fund provides for its self-insurance risk. This fund represents principally net assets and restricted assets set aside for self-insurance amounting to approximately $68.9 million at June 30, 2007.

Changes in the balances of the health insurance program and other self-insurance risks during fiscal years 2007 and 2006 were as follows (expressed in thousands):

		2007	2006
Claims payable at beginning of year	$	44,052	32,603
Incurred claims		139,238	130,755
Claim payments		(134,034)	(119,306)
Claims payable at end of year	$	49,256	44,052

(c) *PRASA*

PRASA is exposed to various risk losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Under the property insurance program, PRASA has $600 million blanket insurance on all real and personal property. The deductible for windstorm and flood is 2%, and 5% for earthquake with a maximum amount of $7.5 million, and $3 million for flood. This policy has a general limit of $10 million per occurrence.

The comprehensive general liability and automobile liability have basic limits of $2 million and the umbrella is $20 million in excess of $2 million, per occurrence. Also, there is an excess of loss coverage of $45 million for losses in excess of $28 million. In the past three years, PRASA has not settled claims in excess of insurance coverage.

(d) SIFC

SIFC provides workers' compensation insurance to public and private employees. This insurance covers workers against injuries, disability, or death because of work- or employment-related accidents, or because illness is suffered as a consequence of their employment. SIFC establishes liabilities for estimated incurred but unpaid benefits and benefit adjustment expenses based on the ultimate cost of settling the benefits. The following table provides a reconciliation of the beginning and ending liability for incurred but unpaid benefits and benefit adjustment expenses for the two most recent fiscal years (expressed in thousands):

		2007	2006
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	$	696,922	733,762
Total incurred benefits		416,080	380,629
Total benefit payments		(425,173)	(417,469)
Liability for incurred but unpaid benefits and benefit adjustment expenses at end of year	$	687,829	696,922

The liability for incurred but unpaid benefits and benefit adjustment expenses is reported as liabilities for automobile accident insurance and workmen's compensation claims in the accompanying statement of net assets.

The liability for compensation benefits is based on historical claims experience data, assumptions and projections as to future events, including claims frequency, severity, persistency, and inflationary trends determined by an independent actuary. The actuarial study also included estimates for medical benefits, benefit adjustment expenses, and reimbursement of premiums. The assumptions used in estimating and establishing the liabilities are reviewed annually based on current circumstances and any adjustments resulting thereof are reflected in operations in the current period.

(e) AACA

AACA operates a system of compulsory insurance for vehicles licensed to be used on public roads and highways in Puerto Rico. This insurance covers death and bodily injuries caused by automobile accidents. The annual premium is $35 per motor vehicle.

The following table provides a reconciliation of the beginning and ending liability for the future benefits for the two most recent fiscal years (expressed in thousands):

		2007	2006
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	$	114,388	107,817
Total incurred benefits		62,806	64,835
Total benefit payments		(58,921)	(58,264)
Liability for incurred but unpaid benefits and benefit adjustment expenses at end of year	$	118,273	114,388

The liability for future benefits is reported as liability for automobile accident insurance and workmen's compensation claims in the accompanying statement of net assets. AACA has recorded this liability, including administrative expenses for claim processing, based on the results of actuarial reports prepared by independent actuaries, determined under two different methods. Death, funeral, disability, dismemberment, and the basic medical hospitalization liabilities were determined using a triangulation method. The extended benefits medical hospitalization reserve uses a regression methodology to predict the ultimate incurred claims for each incurred calendar quarter. Additionally, assumptions are made about the mortality rates of the extended benefit claimants, recognizing the impact of their traumatic injuries on life span.

Changes in the ultimate liabilities for benefit payments may be required as information develops, which varies from experience, provides additional data, or, in some cases, augments data, which previously were not considered sufficient for use in determining the claim liabilities.

(f) ***PRIFA***

PRIFA is responsible for assuring that its property is properly insured. Annually, PRIFA compiles the information of all property owned and its respective market value and purchases its property and casualty insurance policies. Insurance coverage for fiscal year 2007 remained similar to those of prior years. For the last three years, insurance settlements have not exceeded the amount of coverage.

(18) Commitments and Contingencies

Primary Government

The Commonwealth is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Commonwealth only for causes of actions set forth in said act to a maximum amount of $75,000 or $150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Commonwealth may provide its officers and employees with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, excluding the litigation mentioned in the following paragraphs, the Commonwealth reported approximately $400 million as an amount to cover for awarded and anticipated unfavorable judgments at June 30, 2007. This amount was included as other long-term liabilities in the accompanying statement of net assets, and represents the amount estimated as probable liability or a liability with a fixed or expected due date that will require future available financial resources for its payment. The amounts claimed exceed $6 billion; however, the ultimate liability cannot be presently determined. It is the opinion of management that the claims are excessive and exaggerated. Management believes that the ultimate liability in excess of amounts provided, if any, would not be significant.

The Commonwealth is also a defendant in a lawsuit filed in a local district court by an association of primary care health centers seeking to recover from the Commonwealth $800 million of Medicaid funds retained by the Department of Health of the Commonwealth since 1997. In June 2004, the First Circuit Court of San Juan determined that the Commonwealth must return these funds. The Commonwealth appealed this decision. As of June 30, 2007, the Commonwealth accrued $50 million for this legal contingency.

The Commonwealth is a defendant in a class action presented by parents of special education students in the areas of education and healthcare. In October 2006, the San Juan Court of Appeals decided in favor of the parents' request to include damage claims pursuant to the same class action case although not as a remedy in the class action per se. The court now may award damages to the members of the class action and to do so it may look at the claims by dividing them into groups or consider each case individually. This will require that the parents prove the damages suffered. The Commonwealth plans to defend vigorously each individual case. As of June 30, 2007, the Commonwealth accrued $450 million for this legal contingency.

The Commonwealth is a defendant in a lawsuit filed by a group of vehicle owners in the First Circuit Court of San Juan which questions the legitimacy of Act No. 42 of August 1, 2005, as amended. According to this Act, all luxury motor vehicles which are used for private purpose are obligated to pay additional annual fees for the use of the motor vehicle. On March 15, 2007, the First Circuit Court of San Juan ruled against the Commonwealth and ordered the Commonwealth to return the funds collected. The Commonwealth appealed this decision to the Court of Appeals. On January 29, 2008, the Court of Appeals upheld the decision of the First Circuit Court of San Juan. As of June 30, 2007, the Commonwealth accrued $50 million for this legal contingency.

The Commonwealth receives financial assistance from the federal government in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal law and regulations, including the expenditure of resources for eligible purposes. Substantially, all grants are subject to audit under Circular A-133 of the Office of Management and Budget of the United States of America (OMB Circular A-133), all of which are performed at the individual department or agency level. Disallowance as a result of these audits may become liabilities of the Commonwealth. At June 30, 2007, based on an evaluation of pending federal disallowances, the Commonwealth has recorded approximately $50 million as other long-term liabilities in the accompanying statement of net assets. Expenditures that are still subject to audit could be disallowed but management believes any such future disallowances would not be material to the basic financial statements.

Construction commitments at June 30, 2007, entered by PBA, amounted to approximately $238.9 million. In addition, the Commonwealth's construction commitments for public housing facilities amounted to approximately $346.8 million at June 30, 2007.

On November 23, 1998, a global settlement agreement (the Agreement) was entered into by and between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies are to continue making contributions in perpetuity. Pursuant to Act No. 173 of July 30, 1999, which created the Children's Trust (a blended component unit), the Commonwealth assigned and transferred to the Trust all payments that the Commonwealth is entitled to receive under the agreement. Payments received under the agreement and recognized as revenue during the year ended June 30, 2007 amounted to approximately $68.7 million.

Following is a summary of estimated payments to be received by the Trust through the year ending June 30, 2025 (expressed in thousands):

Year ending June 30:		
2008	$	78,679
2009		79,854
2010		80,913
2011		82,070
2012		83,225
2013-2017		432,723
2018-2022		518,021
2023-2025		328,129
Total	$	1,683,614

At June 30, 2007, the Trust had approved commitments to provide assistance to several entities through 58 contracts with balances amounting to approximately $69.6 million.

Discretely Presented Component Units

In the normal course of their operations, the various component units are subject to guarantees, actions brought by third parties seeking damages or entering into commitments. Such actions are disclosed in the separately issued reports of the components units, some of which are summarized below:

(a) GDB

At June 30, 2007, GDB has financial guarantees for public entities for approximately $125 million and for private sector of approximately $128 million. In addition, standby letters of credit to public entities were approximately $521 million and to private sector were approximately $19 million. Commitments to extend credit to public entities were approximately $14 million.

GDB enters into sales of securities under agreements to repurchase. These agreements generally represent short-term debts and are presented as a liability in the statement of net assets. The securities underlying these agreements are usually held by the broker, or its agent, with whom the agreement is transacted. As of June 30, 2007, there were agreements outstanding for $455 million, and during the year, the average amount outstanding was approximately $462 million, the maximum amount outstanding at any month-end was approximately $544 million, and the weighted average interest rate for the year and at year-end was approximately 4.96% and 4.87%, respectively.

GDB issues commercial paper in the U.S. taxable and tax-exempt commercial paper markets, the Euro commercial paper market, and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act. Commercial paper represents unsecured obligations of GDB. The carrying amount of commercial paper at June 30, 2007 was approximately $576 million.

At June 30, 2007, GDB had outstanding interest rate swap agreements with other financial institutions in the aggregate notional amounts of $1.2 billion, having a fair value (payable position) of approximately $29 million. GDB is exposed to credit loss in the event of nonperformance by counterparties.

During 2007, the Development Fund, a blended component unit of GDB, recorded an accrued legal contingency liability of $10 million due to a legal claim for which the court has issued an adverse judgment. The claim was brought by a former industrial client to whom the Development Fund had approved a line of credit to enhance their production capabilities. However, due to noncompliance of client with the conditions of the commitment letter issued by the Development Fund, as well as uncertainties regarding the client's ability to repay the financial facility, the Development Fund was prompted to cancel the commitment letter. The client sued the Development Fund claiming it was responsible for losses sustained. The court held that claimant had incurred in significant expenses to increase their production based on the resources they expected to have available through the line of credit. Eventually, they had to cease their operations. Management has estimated the amount of the claim to be $10 million based on consultation with its internal legal counsel. However, the ultimate liability is still pending court resolution and could differ from the estimated amount.

(b) PRHTA

PRHTA entered into a System and Test Track Turnkey Contract (STTT Contract) with Siemens Transportation Partnership Puerto Rico, S.E. (STT), Juan R. Requena y Asociados, and Alternate Concepts, Inc. (all together known as Siemens) for the purposes of operating and maintaining the urban train system known as the "Tren Urbano." The STTT Contract became effective during 2005 for an initial form of five years with an option by PRHTA to extend the term for an additional five years. The compensation is based on a schedule included in the master agreement, which approximates $4 million on a monthly basis. The total annual operating and maintenance cost including cost of insurance and electricity for fiscal year 2007 was approximately $51.3 million.

In connection with the responsibilities of the PRHTA for mass transportation systems, the Metrobus project was developed. The project consists of bus operations in part of the San Juan metropolitan area named Metrobus I, which operations are conducted by First Transit, a private company, under an agreement of $5.8 million, which expired on June 30, 2007. In addition, the project consists of bus operations between Bayamón and Stop 18 named Metrobus II, which operations are conducted by the Metropolitan Bus Authority (MBA), a discretely presented component unit, under a 36-month agreement of $13.5 million, which expired on June 30, 2007. During June 2003, January 2004, and July 2006, the PRHTA amended the MBA service contract for the purpose of adding certain additional routes to the mass transportation system. The amendment added to the original service contract the amount of $53.1 million with a month-to-month term, which expired on June 30, 2007.

During December 2004, MBA entered into a contract agreement with PRHTA to integrate the Metrobus with the Tren Urbano mass transportation system. The total amount of this contract is approximately $22.2 million and expired on June 30, 2007.

During 1995, MBA entered into a contract agreement with the PRHTA to operate and maintain one of Metrobus' routes from Río Piedras to Old San Juan, provide service for para-transit, and maintain the transfer stations. This contract is renewable every year with an increase of 6% over the last year's contract amount. The total amount of this contract is approximately $1 million and expired on June 30, 2007.

Through Resolution 2007-40, the PRHTA renegotiated and combined all services contracts described above. The resolution established a total service contract amount payable to MBA in the amount of $23.2 million, which will be payable on a monthly basis through June 30, 2008.

At June 30, 2007, PRHTA had outstanding interest rate swap agreements with other financial institutions in the aggregate notional amounts of $589 million, having a fair value (net receivable position) of approximately $1.2 million. PRHTA is exposed to credit loss in the event of nonperformance by the other parties to the swap agreements. However, PRHTA does not anticipate nonperformance by the counterparties.

On February 28, 2003, STT and other parties filed legal claims against PRHTA in the amount of approximately $50 million for damages, amounts withheld, acceleration of work, and other causes of action in connection with the construction of the Tren Urbano. This claim was amended during 2005 to increase the amount to $120 million. PRHTA has responded with several counter claims to STT and other contractors in the Tren Urbano project in amounts exceeding $200 million.

On April 20, 2007, the administrative judge designated this case as a complex litigation and remitted it to the Chief Justice of the Supreme Court who has to assign a presiding judge for the case. The parties are still awaiting such designation. In the opinion of legal counsel, although discovery up to date has shown that it is unlikely that STT will prevail in its allegation against PRHTA, due to the complexities of the case, it is not possible to estimate the amount of any potential loss.

(c) PREPA

In October 1994, PREPA signed a contract with AES Puerto Rico, L.P. (AES) to purchase power of approximately 454 megawatts generated from a coal fluidized bed combustion facility. The term of the agreement is for 25 years. This project commenced operations in November 2002. In March 1995, the authority also signed a contract with EcoEléctrica, L.P. (EcoEléctrica) to purchase power of approximately 507 megawatts from a gas-fired combined cycle power plan. The term of the agreement is for 22 years. This project has been in operation since 2000.

In May 1998, the Municipality of Ponce filed a complaint against PREPA in the San Juan Superior Supreme Court requesting the payment by PREPA of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years. The complaint challenges the application of the net revenues by the authority in making deposits to certain funds under the 1974 Agreement and under a prior trust indenture (now terminated) for the purposes of paying cost of capital improvement and seeks a payment by PREPA in the amount by which the amount available to pay contributions in lieu of taxes and electric energy sales set aside to the Municipality of Ponce has been reduced as a result of such application. PREPA understands that because the Act provided that the contributions in lieu of taxes and electric energy sales set aside are only payable after complying with the PREPA's deposit obligations under the 1974 Agreement and the prior indenture, and that shortfalls do not carry forward as future liabilities of PREPA as describe above, it is legally entitled to make such deposits even if the effect is to reduce such contributions and set aside available to municipalities.

On April 14, 2003, PREPA made a settlement offer consisting of a payment in cash of $68 million and $57 million for electric infrastructure projects in the municipalities. As part of the settlement agreement, the municipalities supported an amendment to the Act that was proposed by PREPA that the amount payable to municipalities be calculated based on a percentage of the net revenues defined on the 1974 Bond Indenture Agreement. Prior to fiscal year 2005, 76 of the 78 municipalities of Puerto Rico had accepted the settlement receiving an aggregate amount of $63.6 million. During fiscal year 2005, the remaining municipalities accepted the settlement offer, receiving $4.4 million. The settlement required PREPA to submit legislation to change the CLT calculation. The new law signed in August 2004 included a transition clause regarding the $68 million payment, stating that this amount was a special CLT that the accepting municipalities would receive with financing provided by GDB. The debt to GDB is guaranteed with the CLT. In connection with the same litigation, GDB approved a line of credit of $57 million, for electric infrastructure projects on municipalities. As of June 30, 2007, PREPA has drawn $41.7 million.

In June 2004, the Office of the Comptroller of the Commonwealth of Puerto Rico (the Comptroller) issued a report stating that PREPA overcharged its clients by approximately $49.8 million, and should reimburse this amount to such clients. After this report was made public, two lawsuits were filed by clients of PREPA demanding the reimbursement of such alleged overcharges. PREPA denies that any overcharges have been made.

On December 2006, two fires damaged one of the PREPA's generating units and the control room, which controls all four units located at Palo Seco plant. As a result, 602 megawatts of oil-fired capacity, representing 11% of the production plant installed; dependable capacity is not currently available. PREPA submitted claims to insurance companies of $122.1 million, including the extra fuel expenses, and has received payments of $5 million during the fiscal year ended June 30, 2007. In addition to the damages to the utility, plant, administrative, and general expenses charged to operations related to noncapitalizable activities amounted to $8 million.

(d) PRIFA

The law that created PRIFA (as amended) requires that, in each fiscal year after fiscal year 2006 through fiscal year 2052, the first $90 million of federal excise taxes received by the Commonwealth be transferred to PRIFA for deposit to PRIFA's infrastructure fund (the Infrastructure Fund). These federal excise taxes consist of taxes received by the Commonwealth from the United States of America in connection with rum and other articles produced in Puerto Rico and sold in the United States of America that are subject to federal excise tax.

A related trust agreement requires PRIFA to deposit to the credit of a sinking fund the federal excise taxes and other moneys deposited to the credit of the Infrastructure Fund in such amounts as are required to meet debt service requirements with respect to certain related bonds. Rum is the only article currently produced in Puerto Rico subject to federal excise tax, the proceeds of which are required to be transferred from the federal government to the Commonwealth.

The federal excise taxes securing the bonds are subject to a number of factors, including the continued imposition and remittance of such taxes to the Commonwealth and conditions affecting the Puerto Rico rum industry. If the federal excise taxes received by the Commonwealth in any fiscal year are insufficient to deposit the amount required by the law into the Infrastructure Fund, the law that enacted PRIFA requires that PRIFA request the director of the OMB to include in the annual budget of the Commonwealth for the corresponding fiscal year an appropriation necessary to cover such deficiency. The Commonwealth's Legislature, however, is not legally obligated to make the necessary appropriation to cover such deficiency.

(e) PRASA

On June 29, 2007, PRASA entered into two forward interest rate swap agreements for the purpose of reducing the risk that an increase in long-term interest rates would have on the amount of money PRASA could borrow to implement its capital improvements program, at the time it is ready to issue its senior lien revenue bonds. The intention of the swaps is to effectively change the PRASA variable interest rate on the bonds to be issued on a future date to a synthetic fixed rate. The floating rate of these agreements will be based upon the Securities Industry and Financial Markets Association (SIFMA) municipal swap index. The aggregate notional amount under such agreements is $930 million on the basis of the PRASA estimate regarding the total principal amount of senior lien, net revenue bonds expected to be issued by PRASA. The agreements evidencing these swaps permit PRASA to terminate them on or prior to the effective date of March 12, 2008, at the agreements' fair market value. The structure of the agreements is such that should long-term market interest rates increase from their date of execution to March 12, 2008, PRASA would receive a termination payment approximating the present value increase in borrowing costs on PRASA senior net revenue bonds, and should long-term market interest rates instead decrease, PRASA would be obligated to make a termination payment that approximates the decrease in such borrowing costs (similarly computed). It is expected that PRASA will execute its option to terminate the swaps at the time it issues the senior revenue bonds to finance a portion of its capital improvement program.

PRASA is defendant in a class action lawsuit presented by customers alleging that the PRASA has over billed them due to the methodology used to estimate consumption. The plaintiffs seek recovery of damages in the amount of $175 million and an injunction enjoining PRASA from continuing to bill using the current methodology. PRASA's potential exposure from this class action lawsuit cannot be presently determined, and as such, no liability is being reported on the accompanying basic financing statements.

(f) *PRTA*

PRTA, through its subsidiary PRTA Holdings, holds shares of Telecomunicaciones de Puerto Rico, Inc. (TELPRI), is the Puerto Rico corporation that was organized for the purpose of acquiring the stock of the Puerto Rico Telephone Company (PRTC) and Celulares Telefonica (CT) from PRTA in connection with the sale transaction of March 2, 1999, where a subsidiary of Verizon, Popular, Inc., and TELPRI's employee stock ownership plan acquired 57% of TELPRI and completed the privatization of PRTC and CT. It is contemplated that all shares of TELPRI held by PRTA Holdings will be sold in public offerings and private placements, and all dividends and proceeds received from the sale of the shares will be distributed to the ERS. The PRTA's 43% investment in TELPRI was carried on the equity method of accounting through December 28, 2000. Although the ownership of the common stock of PRTA Holdings entitles PRTA to the voting right over TELPRI shares, no carrying value is recorded for its investment after the transfer of PRTA Holdings' preferred stock to the Retirement System on December 28, 2000, since such preferred stock entitled the Retirement System to all the economic benefits of the investments in TELPRI.

On March 31, 2000, Verizon delivered notice of claim for indemnity to PRTA related to certain alleged actions of PRTA that occurred before the closing of the purchase transaction describe above. The amount of indemnity sought by Verizon is approximately $105 million, related to several matters including PRTC's exposure to a potential reduction in tariffs or required rebate to clients as a result of an adverse decision by the Federal Communications Commission (FCC) on a regulatory matter. The FCC's decision has been appealed by PRTC and FCC denied such request. In June 2000, PRTA requested Verizon to provide additional information that would enable it to evaluate the merit of claims made, but to date, the additional information has not been submitted.

Management believes that the final resolution of the legal cases will not have a material adverse effect on the financial position and results of operations of PRTA.

(g) *LAPR*

At year-end, LAPR had approximately $28.2 million in accruals to cover the estimated costs related to the liquidation of the Sugar Corporation of Puerto Rico, a blended component unit of LAPR, including, among others: employee severance, pending legal cases, environmental cleanup costs, refinery repair costs, and estimated future losses to be incurred. Management believes these accruals to be sufficient; however, given the many uncertainties involved, the ultimate outcome cannot be determined with certainty at this time, and the actual liquidation costs could be higher or lower than the estimates made. LAPR is also a defendant in various claims amounting to approximately $138.3 million. LAPR is in the process of litigating such claims and the ultimate liability, if any, cannot be presently determined.

(h) *PCSDIPRC*

PCSDIPRC provides insurance coverage over the stocks and deposits of all the cooperatives and the Federation of Cooperatives of Puerto Rico. The deposit base of the cooperatives approximates $6 billion at June 30, 2007.

Fiduciary Component Unit

On June 29, 2007, ERS 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.

As of June 30, 2007, ERS entered into various contracts with outside contractors for construction and remodeling the building facilities. ERS 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.

Environmental Commitments and Contingencies

The following component units' operations include activities that are subject to state and federal environmental regulations:

- **PREPA** – Facilities and operations of PREPA are subject to regulations under numerous federal and commonwealth environmental laws, including the Clean Air Act, Clean Water Act, and the National Pollutant Discharge Elimination System (NPDES). In February 1992, the Environmental Protection Act (EPA) performed an inspection of various facilities of PREPA and became aware of deficiencies in different areas, principally air opacity; water quality; spill prevention control and countermeasures; and underground storage tanks. As result, PREPA agreed to, among other things, make certain capital improvements, undertake supplemental environment projects, and use fuel oil not exceeding certain predetermined levels of sulfur, vanadium, and asphalt in its content.
- **PRSWA** – PRSWA is currently involved in the implementation and development of the Infrastructure Regional Plan for recycling and disposal of solid waste in Puerto Rico. As of June 30, 2007, PRSWA believes that there is no sufficient information available to determine the potential amount of related losses, if any, and no provision for losses has been made to the financial statement. Nevertheless, preventive infrastructure has been constructed to minimize any possible impact or events that occur. In addition, operational plans have been developed to incorporate good maintenance practices.
- **PRIDCO** – Financial responsibility for cleanup costs has been and/or are being undertaken by the industrial potentially responsible parties (PRPs) at the two Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) sites (Vega Alta and Guayama) where the federal government named PRIDCO as a PRP solely for being a part-owner of both sites. Under CERCLA and its regulations, liability for the cleanup cost and damage to natural resources and any assessment of health effects may be imposed on the present and past owners or operators of a facility from which there was a release of hazardous substances. In addition, any person who arranged for the disposal or treatment of hazardous substances at a site from which there was a release may also be liable. The resolution of those legal actions included various environmental issues to which PRIDCO did not stipulate liability under the CERCLA and other federal legislation. CERCLA establishes procedures and standards for responding to the release of hazardous substances, pollutants, and contaminants.

Construction Commitments

As of June 30, 2007, the following component units maintained various unspent construction agreements as follows (expressed in thousands):

Puerto Rico Highways and Transportation Authority	$	762,050
Puerto Rico Electrical Power Authority		475,000
Puerto Rico Aqueduct and Sewer Authority		404,000
Special Communities Perpetual Trust		348,060
University of Puerto Rico		160,305
Puerto Rico Solid Waste Authority		110,722
Puerto Rico Ports Authority		80,042
Puerto Rico Medical Services Authority Administration		52,058
Puerto Rico Infrastructure Financing Authority		35,306
Puerto Rico Conservatory of Music Corporation		17,942
Puerto Rico Trade and Export Company		12,365
Institute of Puerto Rican Culture		10,552
Puerto Rico Industrial Development Company		10,375
Fine Arts Center Corporation		808
Cardiovascular Center Corporation of Puerto Rico and the Caribbean		567
Institutional Trust of the National Guard of Puerto Rico		440
Total	$	2,480,592

(19) Retirement Systems

The Commonwealth sponsors three contributory pension plans (collectively known as the Retirement Systems), which are reported in the accompanying statement of fiduciary net assets:

- Employees' Retirement System of the Government of Puerto Rico and its instrumentalities (ERS)
- The Puerto Rico Judiciary Retirement System (JRS)
- Puerto Rico System of Annuities and Pensions for Teachers (TRS)

Each system is independent; thus, their assets or liabilities may not be transferred from one system to another or used for any purpose other than to benefit the participants of each system.

The Retirement Systems issue financial reports, which are publicly available and include the basic financial statements, the required trend information, and any other required supplementary information. These reports may be obtained by written request to the corresponding retirement system administrator at the addresses detailed in note 1 of each retirement system's basic financial statements.

(a) ERS

Plan Description

The System is a cost-sharing multi-employer defined-benefit plan sponsored by the Commonwealth. ERS was created under Act No. 447 (the Act), approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers substantially all full-time employees of: (1) the Commonwealth's primary government and (2) certain municipalities of Puerto Rico and certain component units of the Commonwealth not having their own retirement systems. Appointed and temporary commonwealth employees become plan members upon their date of employment. Plan members are eligible for a retirement annuity upon reaching the following age:

Police and firemen	Other employees
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

Plan members are eligible for merit annuity with a minimum of 30 years or more of credited service.

On the coordinated plan, a participating employee contributes 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 of age 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 are reduced over $165 per month.

On the noncoordinated plan, the participating employee contributes 8.275% of the monthly salary and does not have any change on the pension benefits upon receipt of social security benefits.

Death benefits are divided into occupational, nonoccupational, and postretirement. Under the occupational benefits, a surviving spouse may receive an annuity equal to 50% of the participating employee's salary at the date of death and each child may receive $10 per month for minor, or student, up to a maximum benefit per family of 100% of the participating employee's salary at the date of death. If no spouse survives, or dies while receiving the annuity payments, each child, 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. Under the nonoccupational benefits, the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of death are paid. Under the postretirement benefits, the beneficiary with a surviving spouse and child 18 or under receive up to 50% (60%, if not covered under Title II of the Social Security Act) of the 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.

On September 24, 1999, an amendment to the Act, which created ERS, was enacted to establish a defined-contribution plan known as System 2000.

System 2000 became effective on January 1, 2000. Employees participating in the defined-benefit plan system at December 31, 1999 had the option to either stay in the defined-benefit plan or transfer to System 2000. Persons employed 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 ERS, together with those of the defined-benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on a formula that assumes that each year the participants' contributions (with a minimum of 8.275% of the participants' salary up to a maximum of 10%) will be invested as instructed by the participant in an account, which will: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Notes; (2) earn a rate equal to 75% of the return of ERS's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined-contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The sponsors' contributions (9.275% of the participants' salary) will be used to fund the defined benefit plan.

System 2000 reduces the retirement age from 65 years to 60 for those employees who joined the original plan on or after January 1, 2000.

Funding Policy

Contribution requirements, which are established by law and are not actuarially determined, are as follows:

Commonwealth and other sponsors	9.275% of applicable payroll
Participants:	
Hired on or before March 31, 1990	5.775% of monthly gross salary up to $550 8.275% of monthly gross salary in excess of $550
Hired on or after April 1, 1990	8.275% of monthly gross salary

(b) JRS

Plan Description

The JRS is a single-employer defined-benefit plan, which is also administered by the ERS. The system was created under Act No. 12, approved on October 19, 1954. Membership is made up of all judges of the Judiciary Branch of the Commonwealth.

The system provides retirement as well as death and disability benefits. Benefits vest after 10 years of service and upon reaching 60 years of age.

Retirement benefits are determined by the application of stipulated benefit ratios to the plan member's average compensation. Average compensation is computed based on the last month of compensation.

The retirement annuity, for which the plan participant is eligible, is limited to a minimum of 25% and a maximum of 75% of the average compensation, except for judges of the Supreme Court for whom the annuity is limited to a minimum of 50% and a maximum of 100% of the average compensation.

Death benefits are divided into occupational, nonoccupational, and postretirement. Under the occupational benefits, a surviving spouse may receive an annuity equal to 50% of the participating employee's salary at the date of death and each child may receive $10 per month for each child, minor, or student, up to a maximum benefit per family of 75% of the participating employee's salary at the date of death. If no spouse survives or dies while receiving the annuity payments, each child, 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. Under the nonoccupational benefits, the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of death is paid. Under the postretirement benefits, the beneficiary with surviving spouse age 60 or over and child age 21 or under will receive up to 60% of the 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 $500.

During 1997, JRS enacted Act No. 177 that provides, effective January 1, 1999, for increases of 3%, every three years, of the pension benefits paid by JRS to those plan participants with three or more years of retirement.

Funding Policy

All participants are required to make contributions to the plan equal to 8% of the applicable payroll. The Commonwealth, as sponsor, must contribute 20% of the applicable payroll. Contributions are established by law and are not actuarially determined.

(c) TRS

Plan Description

The TRS is a single-employer defined-benefit plan sponsored by the Commonwealth. All active teachers of the Department of Education of the Commonwealth are covered by the system under the terms of Act No. 91 of March 29, 2004 that superseded Act No. 218 of 1951. Licensed teachers working in private schools may also participate in the system as long as the required employer and employee contributions are satisfied.

The plan provides retirement, death, and disability benefits. Benefits vest after completion of a given number of years of credited service based on age. Benefits are determined by the application of stipulated benefit ratios to the members' average compensation. Average compensation is computed based on the highest three years of compensation recognized by TRS.

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.

Funding Policy

Effective January 27, 2000, participant contributions were increased to 9% of their compensation, as provided by Act No. 45 of 2000. The Commonwealth, as sponsor, matches the participants' contributions at a rate of 8.5% of the applicable payroll. Contribution rates are established by law and are not actuarially determined.

Other relevant information on the Commonwealth's Retirement Systems is presented below (as of July 1, 2005, for JRS and ERS, and July 1, 2007 for TRS, for latest valuation date):

Membership

	ERS	JRS	TRS	Total
Retirees and beneficiaries currently receiving benefits	99,851	367	28,966	129,184
Current participating employees	107,256	370	48,505	156,131
Total	207,107	737	77,471	285,315

Annual Pension Cost and Net Pension Obligation (Asset)

The Commonwealth's annual pension cost and net pension obligation (asset) of the three pension plans for the year ended June 30, 2007 were as follows (expressed in thousands):

	ERS	JRS	TRS	Total
Annual required contributions	$ 564,217	9,735	341,160	915,112
Interest on net pension obligation (asset)	332,802	(859)	64,790	396,733
Adjustment to annual required sponsors' contributions	(262,137)	677	(50,543)	(312,003)
Annual pension cost	634,882	9,553	355,407	999,842
Statutory sponsors' contributions made	(460,491)	(6,632)	(174,280)	(641,403)
Increase in net pension obligation	174,391	2,921	181,127	358,439
Net pension obligation (asset) at beginning of year	4,135,143	(7,285)	605,663	4,733,521
Net pension obligation (asset) at end of year	$ 4,309,534	(4,364)	786,790	5,091,960

The net pension obligation for ERS and TRS, and the net pension asset of JRS of $5,096 million and $4 million, respectively, are recorded in the accompanying statement of net assets.

The annual required contribution was determined by actuarial valuations for each of the pension plans as described below:

	ERS	JRS	TRS
Date of latest actuarial valuation	July 1, 2005	July 1, 2005	July 1, 2007
Actuarial-cost method	Projected unit credit cost	Projected unit credit cost	Entry age normal
Amortization method	Level percentage of the projected payroll	Level percentage of the projected payroll	Level percentage closed 5% payroll increase per year
Remaining amortization period	21 years	21 years	16 years
Amortization approach	Closed	Closed	Closed

	ERS	JRS	TRS
Asset-valuation method	Market value	Market value	Market value
Actuarial assumptions:			
Inflation	3.5%	3.5%	3.5%
Investment rate of return	8.5	8.5	8.5
Projected salary increases per annum	5.0	5.0	5.0
Cost-of-living adjustments	None	None	None

Three-Year Trend Information

The three-year trend information is as follows (expressed in thousands):

		ERS	JRS	TRS
Annual pension cost (APC):				
Year ended June 30, 2007	$	634,882	9,553	355,407
Year ended June 30, 2006		634,882	9,553	221,449
Year ended June 30, 2005		652,252	8,380	221,449
Percentage of APC contributed:				
Year ended June 30, 2007		72.5%	69.4%	49.0%
Year ended June 30, 2006		65.0	70.0	81.0
Year ended June 30, 2005		60.0	77.0	82.0
Net pension obligation (asset):				
Year ended June 30, 2007	$	4,309,534	(4,364)	786,790
Year ended June 30, 2006		4,135,141	(7,285)	605,663
Year ended June 30, 2005		3,915,315	(10,111)	564,480

Schedule of Funding Progress (Required Supplementary Information – Unaudited)

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (expressed in thousands):

Actuarial valuation date		Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio		Covered payroll	UAAL as a percentage of covered payroll
July 1, 2005	$	2,327,871	12,283,865	9,955,994	19%	$	4,125,866	241%
July 1, 2004		2,141,442	N/A	N/A	N/A		N/A	N/A
July 1, 2003		1,947,402	11,191,357	9,243,955	17		3,334,441	277

The Puerto Rico Judiciary Retirement System (expressed in thousands):

Actuarial valuation date		Actuarial value of assets	AAL	UAAL	Funded ratio		Covered payroll	UAAL as a percentage of covered payroll
July 1, 2005	$	69,797	174,454	104,657	40%	$	29,331	357%
July 1, 2004		67,851	N/A	N/A	N/A		N/A	N/A
July 1, 2003		61,781	166,732	104,951	37		25,711	408

Puerto Rico System of Annuities and Pensions for Teachers (expressed in thousands):

Actuarial valuation date	Actuarial value of assets	AAL	UAAL	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
July 1, 2007	$ 3,163,000	7,756,000	4,593,000	41%	1,370,000	335%
July 1, 2004	2,403,000	4,702,000	2,299,000	51	1,294,000	178
July 1, 2003	2,143,000	4,540,000	2,397,000	47	1,195,000	201

On August 12, 2000, Act No. 174 was approved to allow certain ERS participants to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75% (if 25 or more years of service and age 55, or 30 or more years of service and age 50) or benefits of 65% (if 25 years of service by less than age 55) of their average compensation, which is computed based on the highest 36 months of compensation recognized by ERS. In these cases, the sponsor is responsible for contributing to ERS amounts to cover the benefit payments and the sponsor contribution with respect to the participants covered until the participants reach the normal retirement age.

(20) Subsequent Events

Primary Government

On September 19, 2007 the Commonwealth issued Public Improvement Bonds of 2007, Series A amounting to $408.8 million and Public Improvement Bonds of 2007, Series B amounting to $91.2 million. The net proceeds will be used to carry out certain capital improvements programs authorized by the law. The bonds are payable through 2034 and bear annual interest rates ranging between 5.00% and 5.25%.

On October 18, 2007, the Commonwealth issued tax and revenue anticipation notes amounting to $1,010 million for the purpose of funding a portion of the projected cash flow requirements of the general fund in fiscal year 2008, which requirements result from timing differences between expected disbursements and receipts of taxes and other revenue. The notes are due on July 30, 2008 and bear an annual interest rate of 4.25%.

On May 7, 2008, the Commonwealth issued its $1,099 million Public Improvement Refunding Bonds, Series 2008 A, 2008 B and 2008 C. These bonds were issued for the purpose of (i) reducing the Commonwealth's market risk associated with certain types of variable rate products, including auction rate securities and variable rate demand obligations insured by monocline bond insurers that have recently been downgraded by the rating agencies, and (ii) realizing debt service savings. The bonds are payable through 2032 and bear annual interest rates ranging between 4.00% and 5.63%.

Component Units

(a) PREPA

On September 13, 2007, PREPA and GDB entered into an agreement for a line of credit of $100 million to be used in the recovery of the Palo Seco Plant from fire damages sustained during December 2006. On December 19, 2007, PREPA and a commercial bank entered into an agreement for a line of credit of $100 million to be used also for the recovery of the Palo Seco Plant. For the seven-month period ended January 31, 2008, PREPA received $69.4 million from insurance companies related to its Palo Seco Plant claim for the fire damage recovery.

On September 5, 2007, PREPA entered into an interest-rate swap transaction with UBS AG and Goldman Sachs Capital Markets for two-third and one-third, respectively, of a notional amount of $600 million in bonds to be issued by PREPA. The transaction will expire on September 1, 2008, or the date before the bonds will be issued, if earlier than September 1, 2008. The transaction fixed rate was established at 3.652% per annum. The interest-rate swap transaction is subject to the terms and conditions of an ISDA Master Agreement entered between PREPA and UBS AG on April 18, 2007, and on September 5, 2007 with Goldman Sachs Capital Markets.

On January 30, 2008, PREPA and Bank of America entered into an agreement for line of credit of $50 million to be used for financing fuel purchases.

(b) PRASA

On September 27, 2007, PRASA issued $39.1 million of Series EE of USDA Rural Development Program Bonds, at 4.25% of interest, payable semiannually and maturing in semiannually installments through July 1, 2047. The funds raised by this issuance were used to partially repay the outstanding balance of USDA Rural Development Program lines of credit for construction projects from GDB. The payment of principal and interest on these bonds is guaranteed by the Commonwealth.

On February 14, 2008, PRASA terminated its two forward interest rate swap agreements entered into on June 29, 2007, and is obligated to make a termination payment of approximately $75 million to the holders of the agreements. PRASA funded the termination payment from the proceeds of a revenue bond issuance that occurred on March 2008, as described below. PRASA will report additional interest expense of approximately $75 million during the year ended June 30, 2008 related to the termination payment.

On March 7, 2008, PRASA issued $1,316.2 million of 2008 Series A Revenue Bonds and $22.4 million of 2008 Series B Revenue Bonds to pay a portion of the cost of its capital improvement program and to refinance certain outstanding bond anticipation notes and lines of credit. On March 7, 2008, PRASA also issued $159.1 million 2008 of Series A Revenue Refunding Bonds and $125.7 million of 2008 Series B Revenue Refunding Bond that are both guaranteed by the Commonwealth for the refinancing of its Commonwealth-guaranteed 1995 Series Revenue Refunding Bonds.

(c) PRIFA

On October 25, 2007, the Authority issued $43.3 million in revenue bonds for the purpose of repaying the term loan agreement entered into by PRIFA with GDB for $34.2 million related to the acquisition of certain medical facilities.

(d) PRHIA

On October 2007, PRHIA entered into a contract with the Municipality of Guaynabo (the Municipality) with 13,592 covered lives. Under this contract, the Municipality bears the risk of the basic and special coverage and PRHIA bears the risk of dental and mental coverage. A third-party administrator handles all the administrative work related to the payment of claims for the services provided outside the Municipality's facilities. As a result of this arrangement, PRHIA no longer receives the contribution portion of the Municipality.

(e) COFINA

On July 31, 2007, COFINA issued $2,668 million 2007 Series A bonds, and $1,333 million 2007 Series B bonds for the payment and retirement of a portion of the extra-constitutional debt owed to GDB and PFC, which was outstanding as of June 30, 2007. GDB received $1.7 billion in partial payment of the $2.8 billion of its public sector loans considered extra constitutional debt.

Fiduciary Funds

On January 29, 2008 and May 28, 2008 ERS issued senior pension funding bonds amounting to $1,589 million and $1,059 million respectively to increase funds currently available to pay benefits and reduce its unfunded accrued actuarial pension liability. The bonds are payable through 2058 and bear annual interest rates ranging between 5.85% and 6.45%

(21) Debt Service Deposit Agreements

On May 26, 2005 (but effective on July 1, 2005), the Commonwealth, PFC, and GDB (together the Commonwealth) and Lehman Brothers Special Financing Inc. (Lehman) entered into Debt Service Deposit Agreements (DSD Agreements), the objective of which was for the Commonwealth to secure an upfront payment in exchange for granting Lehman the rights to earnings generated from eight of its debt service funds. Seven of the funds are associated with the commonwealth's PFC bonds, presented in the accompanying basic financial statements as commonwealth appropriation bonds, and one fund is associated with the Commonwealth's general obligation bonds. The upfront payment, which amounted to $82.7 million, was received on May 26, 2005 and equaled the present value of the projected earnings income adjusted for credit timing risks as well as an appropriate amount of compensation for Lehman.

With the upfront payment made as explained above, the Commonwealth delivers to Lehman the required and scheduled debt service deposits and Lehman delivers qualified government debentures, which will mature before the next debt service payment date at an amount approximating such next debt service payment. Lehman will attempt to earn sufficient funds on the debt service deposit amounts, less its cost for the qualified government debentures, to make back the $82.7 million over time. At the same time, the Commonwealth will be managing its borrowings and investments by increasing the predictability of its cash flows from earnings on its investments and not for purpose of speculation. The Commonwealth acknowledges that, in exchange for the upfront payment received, it is foregoing its right to receive investment earnings on the deposit amounts referred to above in the future and that, by accepting the upfront payment, the Commonwealth has minimized the risks resulting from fluctuations in interest rates during the term of the DSD Agreements but also has foregone the possibility of receiving greater returns on such amounts from such fluctuations.

Under the DSD Agreements, the Commonwealth will be exposed to the payment to Lehman of a Termination Amount, as defined in the agreement, principally upon the occurrence of redemption or a defeasance of the related bonds on or prior to the last scheduled deposit date. The amount of the Termination Amount will vary depending on various market conditions, as defined in the DSD Agreements. Under certain market conditions, the Termination Amount owed to Lehman by the Commonwealth may exceed the amount of the original upfront payment received.

The $82.7 million upfront payment received by the Commonwealth was recognized as other revenue for budgetary purposes in 2005; however, under U.S. generally accepted accounting principles, such upfront payment was deferred and is being recognized proportionally over the future periods the Commonwealth would have otherwise earned such interest earnings. As the effective date of DSD Agreements was July 1, 2005, all of the $82.7 million upfront payment received in 2005 had been recorded as deferred revenue. During fiscal year 2007, approximately $6.5 million was amortized into other revenue in the accompanying statement of activities.

(22) Derivatives

As of June 30, 2007, the Commonwealth was party to the following interest-rate swap agreements (notional amount and fair value in thousands):

Date	Notional amount	Floating rate indicator (pays)	June 30, 2007 Receives Type	June 30, 2007 Receives Rate	June 30, 2007 Pays Type	June 30, 2007 Pays Rate	Maturity date	Fair value June 30, 2007
April 13, 2004	$ 51,600	LIBOR	Fixed	3.3080%	Variable	0.2500%	May 27, 2021	$ 1,076
April 13, 2004	56,000	LIBOR	Fixed	3.5820	Variable	3.4313%	June 27, 2024	412
April 13, 2004	56,000	LIBOR	Fixed	3.5590	Variable	3.3415%	June 29, 2027	(535)
April 13, 2004	55,975	LIBOR	Fixed	3.5750	Variable	3.3415%	June 29, 2028	(595)
April 13, 2004	19,290	LIBOR	Fixed	3.5700	Variable	3.3415%	June 29, 2029	(185)
April 13, 2004	30,710	LIBOR	Fixed	3.5700	Variable	3.3415%	June 29, 2029	(297)
April 13, 2004	50,000	LIBOR	Fixed	3.5730	Variable	3.3415%	June 29, 2029	(496)
April 13, 2004	61,975	LIBOR	Fixed	3.5740	Variable	3.3415%	June 29, 2029	(582)
April 13, 2004	62,000	LIBOR	Fixed	3.5090	Variable	3.2883%	June 29, 2029	(395)
June 21, 2006	1,273,778	3 m LIBOR	3 m LIBOR X .67	3.0820	BMA	3.7300%	July 1, 2035	13,475
		BMA	Fixed	0.0441	N/A	N/A	N/A	4,492
August 10,2006	30,005	N/A	CPI+0.98	2.2850	Fixed	4.26	July 1, 2018	(1,495)
August 10,2006	31,280	N/A	CPI+1.00	2.3050	Fixed	4.29	July 1, 2019	(1,560)
August 10,2006	32,625	N/A	CPI+1.02	2.3250	Fixed	4.32	July 1, 2020	(1,629)
August 10,2006	32,815	N/A	CPI+0.90	2.2050	Fixed	4.20	July 1, 2021	(1,639)
	$ 1,844,053							10,047

The purpose of the interest rate agreements issued on April 13, 2004 in the notional amount of $448 million was to hedge the Commonwealth's variable rate debt exposure and the interest rate risks associated therewith in relation to the Puerto Rico Public Improvement Refunding Bonds, Series 2004 B.

On June 21, 2006 (with effective date of July 1, 2006), the Commonwealth entered into a basis swap agreement in the notional amount of $1.3 billion with an amortization schedule matching the long-term maturities of outstanding general obligation and refunding bonds issued in various years from 1998 to 2005. Additional-basis swap agreements are expected to cover the 2006 General Obligation Bonds awaiting issuance. Under the terms of a master swap agreement, the Commonwealth will pay quarterly commencing on October 1, 2006 a floating rate equal to the tax-exempt Bond Market Association (BMA) index in exchange for receiving a floating rate equal to 67% of the taxable LIBOR index reset each week and a fixed rate payment of 0.4409% per annum, quarterly for the term of swaps. This basis swap provides the Commonwealth the cash flow benefit of the basis annuity in exchange for the Commonwealth taking tax and other basis risks similar to the risks taken in its outstanding LIBOR-hedged synthetic fixed rate Public Refunding Bonds, Series 2004 described above.

On August 2, 2006 (with effective date of August 10, 2006), the Commonwealth entered into an interest rate swap agreement in the notional amount of $126.7 million. Said agreement is in connection with the issuance of the Public Improvement Bonds of 2006, Series A, subject to bear interest at the Consumer Price Index (CPI) rate. Through this agreement, the Commonwealth is required to pay a fixed interest rate and is entitled to receive a floating interest rate equal to the CPI rate, each based on a notional amount equal to the principal amount of the CPI bonds.

By using derivative financial instruments to hedge the exposure to changes in interest rates, the Commonwealth exposes itself to credit risk, market-access risk, and basis risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Commonwealth, which creates a credit risk for the Commonwealth. When the fair value of the derivative contract is negative, the Commonwealth owes to the counterparty and, therefore, does not possess credit risk. The Commonwealth minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties whose credit rating is acceptable under the investment policies of the Commonwealth.

Market risk is the adverse effect on the value of a financial statement instrument that results from a change in interest rates. The market risk associated with an interest rate swap contract is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. The Commonwealth assesses interest rate cash flows risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected cash flows and evaluating hedging opportunities. The Commonwealth maintains risk management control systems to monitor interest rate cash flow risk attributable to both the Commonwealth outstanding or forecasted debt obligations as well as the Commonwealth offsetting hedge positions.

Basis risk arises when different indexes are used in connection with a derivative. The 2006 swap exposes the government to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. If a change occurs that results in the rates moving to convergence, the expected cost savings may not be realized. The Commonwealth assesses basis risk by following the aforementioned market risks control system.

COMBINING, INDIVIDUAL FUND
FINANCIAL STATEMENTS AND SCHEDULES

GENERAL FUND

The general fund is the primary operating fund of the Commonwealth. The general fund is used to account for resources traditionally associated with government, which are not required legally or by sound financial management to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, education, and economic development. Following is the supplemental schedule of expenditures – budget and actual – general fund.

COMMONWEALTH OF PUERTO RICO

Supplemental Schedule of Expenditures by Agency – Budget and Actual –
Statutory Basis – General Fund

Year ended June 30, 2007

(In thousands)

	Original budget	Amended budget	Actual	Variance
Expenditures:				
Current:				
General government				
Senate of Puerto Rico	$ 33,599	33,219	33,219	—
House of Representatives of Puerto Rico	44,422	44,422	45,358	(936)
Comptroller's Office	41,733	41,733	42,005	(272)
Governor's Office	5,104	4,648	4,157	491
Office of Management and Budget	42,837	42,990	36,910	6,080
Planning Board	16,146	15,838	14,138	1,700
Constructions and Land Subdivisions Appeals Board	1,409	1,401	1,260	141
Department of State	7,679	7,658	7,658	—
Department of the Treasury	162,568	166,444	164,137	2,307
Central Office of Personnel Administration	7,321	7,306	7,078	228
Commonwealth Elections Commission	33,816	34,273	37,735	(3,462)
Federal Affairs Administration	6,255	6,255	6,034	221
General Services Administration	572	601	559	42
Municipal Complaints Hearing Commission	4,587	5,460	4,613	847
Civil Rights Commission	867	867	868	(1)
Office of the Citizen's Ombudsman	5,049	5,000	4,992	8
Appellative Board of the Personnel System Administration	1,708	1,705	1,612	93
Rules and Permits Administration	6,281	6,275	5,696	579
Commonwealth's Commission to Settle Municipal Complaints	185	180	179	1
Legislative Affairs Office	975	775	525	250
Commission for the Public Service Work Relations	2,287	2,233	2,004	229
Government Ethics Board	9,890	9,890	9,890	—
Legislative Affairs Office	7,258	7,763	7,457	306
Office of the Superintendent of the Capitol	10,022	10,022	10,032	(10)
Comptroller's Special Reports Joint Commission	636	636	636	—
Legislative Donation Commission	671	746	670	76
Coordination Office for Special Communities of Puerto Rico	8,900	9,090	8,916	174
Public Affairs	4,230	4,230	3,807	423
Governor's Secretary Office	9,384	9,316	9,240	76
Total general government	476,391	480,976	471,385	9,591
Public safety				
Puerto Rico General Court of Justice	313,103	313,171	321,514	(8,343)
State Civil Defense Agency	—	328	328	—
Commission of Investigation, Processing and Appeals Board	676	671	671	—
Department of Justice	142,924	144,230	134,739	9,491
Puerto Rico Police Department	839,757	849,785	840,798	8,987
Puerto Rico Firefighters Corps	69,777	69,328	64,013	5,315
Puerto Rico National Guard	8,247	8,680	8,680	—
Public Service Commission	12,286	12,284	11,265	1,019
Consumer Affairs Department	13,558	13,506	12,013	1,493
Juvenile Institutions Administration	90,014	91,847	92,100	(253)
Corrections Administration	377,757	377,045	374,921	2,124
Natural Resources Administration	44,494	49,193	44,743	4,450
Department of Correction and Rehabilitation	4,602	4,766	4,766	—
Parole Board	2,879	2,796	2,546	250
Forensic Sciences Institute	15,325	15,325	14,653	672
Special Prosecutor Panel	1,925	1,925	1,925	—
Pre-Trial Services Office	7,422	7,421	6,884	537
Correctional Health	81,282	81,279	85,083	(3,804)
Criminal Justice College	7,323	7,323	6,591	732
Medical Emergencies Service	26,060	26,167	25,667	500
Total public safety	2,059,411	2,077,070	2,053,900	23,170
Health				
Environmental Quality Board	12,308	13,018	12,021	997
Department of Health	299,339	303,074	265,273	37,801
Mental Health and Drug Addiction Services Administration	121,291	159,678	122,160	37,518
Puerto Rico Medical Service Administration	1,700	1,700	51,700	(50,000)
Solid Waste Authority of Puerto Rico	4,624	4,624	4,385	239
Puerto Rico Health Insurance Administration	989,386	950,611	1,124,905	(174,294)
Total health	1,428,648	1,432,705	1,580,444	(147,739)

(Continued)

COMMONWEALTH OF PUERTO RICO

Supplemental Schedule of Expenditures by Agency – Budget and Actual – Statutory Basis – General Fund

Year ended June 30, 2007

(In thousands)

	Original budget	Amended budget	Actual	Variance
Public housing and welfare				
Rural Housing Administration	—	—	1,298	(1,298)
Office of Youth Affairs	6,919	6,864	6,427	437
Puerto Rico Volunteers Service Corps	9,830	10,925	10,425	500
Department of Labor and Human Resources	2,041	2,021	1,825	196
Labor Relations Board	994	994	960	34
Department of Housing	25,726	26,902	24,329	2,573
Department of Recreation and Sports	51,991	53,047	49,394	3,653
Administration for the Horse Racing Sport and Industry	4,007	4,535	4,183	352
Women's Affairs Commission	5,331	5,231	4,468	763
Office of the Veteran's Ombudsman	3,245	3,244	3,132	112
Department of Family	54,808	55,027	51,726	3,301
Family and Children Administration	150,715	150,665	144,728	5,937
Minors Support Administration	10,927	10,912	10,612	300
Vocational Rehabilitation Administration	13,455	13,452	13,623	(171)
Social Economic Development Administration	97,710	94,447	75,889	18,558
Office of the Disabled Persons Ombudsman	3,580	3,804	3,645	159
Office for Elderly Affairs	3,740	3,740	3,353	387
Patient Ombusman	4,399	4,357	3,917	440
Right to Employment Administration	15,463	15,974	13,688	2,286
Cantera's Peninsula Integral Development Company	413	413	392	21
Industries for the Blind, Mentally Retarded, and Other Disabled Persons of Puerto Rico	150	150	150	—
Administration for the Care and Development of the Childhood	13,142	12,638	11,462	1,176
Total public housing and welfare	478,586	479,342	439,626	39,716
Education				
Department of Education	2,417,401	2,419,637	2,610,937	(191,300)
State Office for Historic Preservation	2,144	2,203	2,205	(2)
General Education Council	2,023	2,013	1,838	175
Athenaeum of Puerto Rico	475	475	475	—
Institute of Puerto Rico Culture	30,242	30,291	28,357	1,934
School of Plastics Arts	3,096	3,247	3,077	170
University of Puerto Rico	790,746	790,746	786,746	4,000
Musical Arts Corporation	6,182	6,182	5,884	298
Fine Arts Center Corporation	5,642	5,642	5,278	364
Puerto Rico Public Broadcasting Corporation	19,379	19,379	18,454	925
Puerto Rico Conservatory of Music Corporation	4,556	4,556	4,243	313
Puerto Rico Council of Higher Education	29,540	29,540	27,091	2,449
Total education	3,311,426	3,313,911	3,494,585	(180,674)
Economic development				
Department of Transportation and Public Works	73,940	74,443	69,677	4,766
Department of Natural and Environmental Resources	1,857	1,926	2,631	(705)
Department of Agriculture	22,790	24,274	23,375	899
Department of Economic Development and Commerce	68	(12)	(12)	—
Cooperative Enterprises Development Administration	3,162	3,113	3,031	82
Puerto Rico Highway and Transportation Authority	6,000	6,000	6,000	—
Cooperative Enterprises Inspector's Office	792	961	882	79
Rural Development Corporation	4,016	4,016	3,914	102
Department of Economic Development and Commerce	3,292	3,292	2,843	449
Energy Affairs Administration	149	156	141	15
Culebra Conservation and Development Authority	654	654	589	65
Puerto Rico Infraestructure Financing Agency	90,000	90,000	87,000	3,000
Puerto Rico Industrial Development Company	15,000	14,999	14,999	—
Government Development Bank for Puerto Rico	1,000	1,000	1,000	—
Puerto Rico Metropolitan Bus Authority	5,500	8,500	6,500	2,000
Puerto Rico Maritime Transportation Authority	12,000	14,500	11,750	2,750
Puerto Rico Tourism Company	4,259	4,259	3,034	1,225
Agricultural Services and Development Administration	95,105	93,530	93,530	—
National Parks Company of Puerto Rico	23,000	23,000	21,500	1,500
Corporation for the Development of the Film Industry in Puerto Rico	1,164	1,148	1,032	116
Puerto Rico Land Administration	313	313	313	—
Puerto Rico Trade and Export Corporation	10,184	10,252	9,783	469
Total economic development	374,245	380,324	363,512	16,812

(Continued)

COMMONWEALTH OF PUERTO RICO

Supplemental Schedule of Expenditures by Agency – Budget and Actual – Statutory Basis – General Fund

Year ended June 30, 2007

(In thousands)

		Original budget	Amended budget	Actual	Variance
Intergovernmental					
Municipal Service Administration		382,608	382,859	382,054	805
Total intergovernmental		382,608	382,859	382,054	805
Total expenditures	$	8,511,315	8,547,187	8,785,506	(238,319)
Operating transfer-out to other funds:					
Office of Management and Budget	$	177,900	177,900	177,900	—
Employees' Retirement System of the Government of Puerto Rico and its Intumentalities		211,033	211,035	206,220	4,815
Puerto Rico System of Annuities and Pensions for Teachers		60,960	60,960	57,960	3,000
Contributions to Political Parties		603	900	900	—
Transfer of Unused Appropriation Fund (Legislative Branch Only)		13,993	13,993	13,993	—
Transfer of Treasury – Transfer to Debt Service		512,197	476,025	464,400	11,625
	$	976,686	940,813	921,373	19,440

NONMAJOR GOVERNMENTAL FUNDS

Special Revenue Funds

Special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditure for specific purposes.

Public Buildings Authority Special Revenue Fund: The operating fund of a blended component unit used to account for the operation, maintenance, equipment replacement, and other extraordinary operation and maintenance costs of the buildings and facilities that, when constructed, are leased to the Commonwealth's primary government agencies.

Debt Service Funds

The debt service funds are used to account for the accumulation of resources predominantly for, and the payment of, general long-term bonds principal, interest, and related costs other than bonds payable from operations of proprietary fund types, pension trust funds, and discretely presented component units. Long-term debt and interest due on July 1 of the following year are accounted for as a fund liability if resources are available as of June 30 for its payment.

The Children's Trust Debt Service Fund: The debt service fund of The Children's Trust (a blended component unit) accounts for the accumulation of resources for payment of interest and principal on long-term obligations financed with moneys to be received by the Commonwealth from the global settlement agreement signed by certain tobacco companies.

Public Buildings Authority Debt Service Fund: A blended component unit engaged in the construction and/or acquisition of building facilities for lease mainly to the Commonwealth's primary government agencies. Its debt service fund is used to account for the accumulation of resources for the payment of revenue bonds and other liabilities incurred to finance the construction of the buildings and facilities.

Puerto Rico Maritime Shipping Authority Debt Service Fund: This is the remainder of a former shipping company owned by the Commonwealth. Its debt service fund is used to account for the accumulation of resources for the payment of the long-term liability that resulted from the sale of its marine operations. This fund is mainly subsidized from appropriations and operating transfers from the general fund.

Capital Project Funds

Capital project funds are used to account for the financial resources used for the acquisition or construction of major capital facilities not being financed by proprietary fund types, pension trust funds, and discretely presented component units.

Commonwealth Public Improvements Funds and Other Funds: These funds present the activities of the capital improvements program of the Commonwealth, financed with the proceeds of the general obligation bonds.

COMMONWEALTH OF PUERTO RICO

Combining Balance Sheet – Nonmajor Governmental Funds

June 30, 2007

(In thousands)

	Special revenue	Debt service				Capital projects	
Assets	**Public Buildings Authority**	**The Children's Trust**	**Public Buildings Authority**	**Puerto Rico Maritime Shipping Authority**	**Total**	**Commonwealth of Puerto Rico**	**Total nonmajor governmental funds**
Cash and cash equivalents in commercial banks	$ 9,051	—	—	1,591	1,591	33,502	44,144
Cash and cash equivalents in component unit banks	9,108	—	—	1,940	1,940	317,056	328,104
Investments	—	114,862	—	—	114,862	—	114,862
Receivables, net:							
Accounts	9,938	—	—	—	—	671	10,609
Loans and advances	—	—	—	—	—	36	36
Accrued interest	—	441	—	8	449	—	449
Due from:							
Other funds	125,450	—	21,347	—	21,347	31,214	178,011
Component units	44,074	—	—	—	—	—	44,074
Other governmental entities	394	—	—	—	—	—	394
Restricted cash and cash equivalents in commercial banks	—	—	150,100	—	150,100	—	150,100
Real estate held for future development	14,386	—	—	—	—	1,852	16,238
Total assets	$ 212,401	115,303	171,447	3,539	290,289	384,331	887,021
Liabilities and Fund Balances							
Liabilities:							
Accounts payable and accrued liabilities	$ 46,963	—	—	776	776	28,945	76,684
Due to component units	20,374	—	—	—	—	—	20,374
Interest payable	—	—	80,608	1,433	82,041	—	82,041
Notes payable	129,112	—	—	—	—	—	129,112
Bonds payable	—	—	75,690	—	75,690	—	75,690
Total liabilities	196,449	—	156,298	2,209	158,507	28,945	383,901
Fund balances:							
Reserved for:							
Encumbrances	—	—	—	—	—	97,721	97,721
Unreserved reported in:							
Debt service funds	—	115,303	15,149	1,330	131,782	—	131,782
Special revenue funds	15,952	—	—	—	—	—	15,952
Capital projects funds	—	—	—	—	—	257,665	257,665
Total fund balances	15,952	115,303	15,149	1,330	131,782	355,386	503,120
Total liabilities and fund balances	$ 212,401	115,303	171,447	3,539	290,289	384,331	887,021

See accompanying independent auditors' report.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Revenue, Expenditures, and Changes in Fund Balances – Nonmajor Governmental Funds

Year ended June 30, 2007

(In thousands)

	Special revenue	Debt service				Capital projects	
	Public Buildings Authority	The Children's Trust	Public Buildings Authority	Puerto Rico Maritime Shipping Authority	Total	Commonwealth of Puerto Rico	Total nonmajor governmental funds
Revenue:							
Revenue from global tobacco settlement agreement	$ —	68,665	—	—	68,665	—	68,665
Interest and investment earnings	7,438	4,468	—	236	4,704	—	12,142
Revenue from Puerto Rico Sales Tax Financing Corporation	—	—	—	16,956	16,956	—	16,956
Intergovernmental	—	—	—	—	—	16,309	16,309
Other	5,251	—	—	13	13	—	5,264
Total revenue	12,689	73,133	—	17,205	90,338	16,309	119,336
Expenditures:							
Current:							
General government	182,623	—	—	—	—	41,641	224,264
Public safety	—	—	—	—	—	1,108	1,108
Health	—	—	—	—	—	7,059	7,059
Public housing and welfare	—	—	—	—	—	1,773	1,773
Education	—	—	—	—	—	23,503	23,503
Economic development	—		—	814	814	18,092	18,906
Intergovernmental	—	—	—	—	—	166,895	166,895
Capital outlays	—	—	—	—	—	56,445	56,445
Debt service:							
Principal	—	12,030	75,690	—	87,720	—	87,720
Interest and other	—	60,470	97,564	16,956	174,990	—	174,990
Debt issue costs	—	—	—	—	—	8,330	8,330
Total expenditures	182,623	72,500	173,254	17,770	263,524	324,846	770,993
Excess (deficiency) of revenue over (under) expenditures	(169,934)	633	(173,254)	(565)	(173,186)	(308,537)	(651,657)
Other financing sources (uses):							
Transfers in	—	—	162,153	—	162,153	—	162,153
Transfers out	(6,454)	(243)	—	(674)	(917)	(328,418)	(335,789)
Long-term debt issued	—	—	—	—	—	716,565	716,565
Total other financing sources (uses)	(6,454)	(243)	162,153	(674)	161,236	388,147	542,929
Net change in excess (deficiency) of revenue and other fund balances (deficit)	(176,388)	390	(11,101)	(1,239)	(11,950)	79,610	(108,728)
Fund balances, beginning of year	192,340	114,913	26,250	2,569	143,732	275,776	611,848
Fund balances, end of year	$ 15,952	115,303	15,149	1,330	131,782	355,386	503,120

See accompanying independent auditors' report.

NONMAJOR PROPRIETARY FUNDS

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the government is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Disability Insurance: It was created by Act 139 on June 26, 1968. It is used to account for disability benefits to remedy temporarily the loss of income as a result of disability caused by sickness or accident unrelated to the employment.

Drivers' Insurance: It was created by Act 428 on May 15, 1950. It is used to account for contributions made by the drivers and their employers to provide a social security plan for the benefit of the drivers in Puerto Rico. The plan also includes payment of benefits for health and life insurance.

Puerto Rico Water Pollution Control Revolving Fund: It was created by Act No. 44 on June 21, 1988, as amended. It is administered, pursuant to Act No. 9 of June 18, 1970, as amended, by the Puerto Rico Environmental Quality Board (EQB). Pursuant to such Act, EQB is authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (EPA) for lending activities.

Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund: It was created by Act No. 32 on July 7, 1997. It is administered, pursuant to Act No. 9 of June 18, 1970, as amended, by the Puerto Rico Department of Health (DOH). Pursuant to such act, DOH, on behalf of the Commonwealth, is authorized to enter into operating and capitalization grant agreements with the EPA for lending activities.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Net Assets – Nonmajor Proprietary Funds

June 30, 2007

(In thousands)

		Business type activities – nonmajor enterprise funds				
Assets		**Disability insurance**	**Drivers' insurance**	**Puerto Rico Water Pollution Control Revolving Fund**	**Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund**	**Total**
Current assets:						
Cash and cash equivalents in commercial banks	$	—	37,585	59,013	6,609	103,207
Cash and cash equivalents in governmental banks		80,059		—	—	80,059
Receivables, net:						
Insurance premiums, net		3,545	1,055	—	—	4,600
Component units		—	—	7,519	1,328	8,847
Accrued interest		217	80	1,501	692	2,490
Other		203	36	109	76	424
Total current assets		84,024	38,756	68,142	8,705	199,627
Noncurrent assets:						
Loans receivable from component units, excluding current portion, net		—	—	148,406	71,920	220,326
Restricted investments		35,606	—	—	—	35,606
Other		—	—	1,710	—	1,710
Total assets		119,630	38,756	218,258	80,625	457,269
Liabilities and Net Assets						
Current liabilities:						
Accounts payable and accrued liabilities		1,730	183	417	157	2,487
Deferred revenue		—	28	—	—	28
Compensated absences		887	712	—	—	1,599
Insurance benefits payable		851	283	—	—	1,134
Total current liabilities		3,468	1,206	417	157	5,248
Noncurrent liabilities – compensated absences		332	—	—	—	332
Total liabilities		3,800	1,206	417	157	5,580
Net assets:						
Restricted for:						
Payment of insurance benefits		115,830	37,550	—	—	153,380
Capital projects		—	—	217,841	80,468	298,309
Total net assets (deficit)	$	115,830	37,550	217,841	80,468	451,689

See accompanying independent auditors' report.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Revenue, Expenses and Changes in Net Assets –
Nonmajor Proprietary Funds

Year ended June 30, 2007

(In thousands)

	Business type activities – nonmajor enterprise funds				
	Disability Insurance	**Drivers' Insurance**	**Puerto Rico Water Pollution Control Revolving Fund**	**Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund**	**Total**
Operating revenues:					
Insurance premiums	$ 15,711	4,602	—	—	20,313
Interest	—	—	5,860	1,574	7,434
Total operating revenues	15,711	4,602	5,860	1,574	27,747
Operating expenses:					
Disability and drivers' insurance benefits	3,352	1,158	—	—	4,510
General, administrative, and other operating expenses	17,232	3,981	587	550	22,350
Total operating expenses	20,584	5,139	587	550	26,860
Operating income (loss)	(4,873)	(537)	5,273	1,024	887
Nonoperating revenue:					
Contributions from federal government	—	—	16,821	20,079	36,900
Interest and investment earnings	1,241	967	—	—	2,208
Total nonoperating revenue	1,241	967	16,821	20,079	39,108
Income (loss) before transfers	(3,632)	430	22,094	21,103	39,995
Transfers from general fund	—	—	3,364	4,094	7,458
Transfers to general fund	—	—	—	(87)	(87)
Net change in net assets	(3,632)	430	25,458	25,110	47,366
Net assets, at beginning of year	119,462	37,120	192,383	55,358	404,323
Net assets, at end of year	$ 115,830	37,550	217,841	80,468	451,689

See accompanying independent auditors' report.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Cash Flows – Nonmajor Proprietary Funds

Year ended June 30, 2007

(In thousands)

		Business type activities – nonmajor enterprise funds				
		Disability Insurance	**Drivers' Insurance**	**Puerto Rico Water Pollution Control Revolving Fund**	**Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund**	**Total**
Cash flows from operating activities:						
Receipts from customers and users	$	19,316	4,539	—	—	23,855
Other receipts		—	—	13,209	2,220	15,429
Payments to suppliers and employees		(17,774)	(4,443)	—	—	(22,217)
Payments of insurance benefits		(3,391)	(1,232)	—	—	(4,623)
Other payments		—	—	(24,835)	(26,039)	(50,874)
Net cash used in operating activities		(1,849)	(1,136)	(11,626)	(23,819)	(38,430)
Cash flows from noncapital financing activities:						
Intergovernmental grants and contributions		—	—	16,821	20,079	36,900
Transfers from general fund		—	—	3,364	4,094	7,458
Transfers to other funds		—	—	—	(87)	(87)
Net cash provided by noncapital financing activities		—	—	20,185	24,086	44,271
Cash flows from investing activities:						
Interest received on deposits and investments		1,214	964	—	—	2,178
Purchases of investments		(2,133)	—	—	—	(2,133)
Net cash provided by (used in) investing activities		(919)	964	—	—	45
Net increase (decrease) in cash and cash equivalents		(2,768)	(172)	8,559	267	5,886
Cash and equivalents at beginning of year		82,827	37,757	50,454	6,342	177,380
Cash and cash equivalents at end of year	$	80,059	37,585	59,013	6,609	183,266
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:						
Operating income (loss)	$	(4,873)	(537)	5,273	1,024	887
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:						
Interests earned on deposits loans and investments		—	—	62	(235)	(173)
Changes in operating assets and liabilities:						
Decrease (increase) in accounts and loan receivable		3,605	(63)	(16,546)	(24,464)	(37,468)
Increase (decrease) in deferred revenues		—	2	—	—	2
Increase (decrease) in compensated absences		(632)	(554)	—	—	(1,186)
Increase (decrease) in liability for insurance benefits payable		(39)	(74)	—	—	(113)
Increase (decrease) in accounts payable and accrued liabilities		90	90	(415)	(155)	(390)
Decrease in other assets		—	—	—	11	11
Total adjustments		3,024	(599)	(16,899)	(24,843)	(39,317)
Net cash used in operating activities	$	(1,849)	(1,136)	(11,626)	(23,819)	(38,430)

See accompanying independent auditors' report.

FIDUCIARY FUNDS

Fiduciary funds are used to account for held by the Commonwealth in a trustee capacity, or as an agent for individuals, organizations, and other governmental units. Following are the Commonwealth's fiduciary funds:

Pension Trust Funds

The pension trust funds are used to account for the assets, liabilities, and net assets available for pension benefits held in trust for the public employees of the Commonwealth.

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS): ERS is the administrator of a defined-benefit pension plan, which covers all regular employees of the Commonwealth and its instrumentalities and of certain municipalities and component units not covered by their retirement systems. On September 24, 1999, an amendment to the law that created ERS was enacted with the purpose of establishing a new defined-contribution pension plan (System 2000) for persons joining the government on or after January 1, 2000.

Puerto Rico System of Annuities and Pensions for Teachers (TRS): TRS provides retirement benefits to all teachers of the Department of Education of the Commonwealth, all pensioned teachers who work in the Teachers' Association of Puerto Rico, and those who practice in private institutions accredited by the Department of Education of Commonwealth. TRS provides retirement, death, and disability benefits.

Puerto Rico Judiciary Retirement System (JRS): JRS is administered by the ERS and covers all individuals holding a position as Justice of the Supreme Court, Judge of the former Superior Court, Judge of District Court, or the Municipal Judges of the Commonwealth. The system provides retirement as well as death and disability benefits.

Agency Fund

Agency fund is used to account for assets held by the Commonwealth as an agent for individuals, private organizations, and other governments. This fund is custodial in nature (assets equal liabilities) and does not involve measurement of the results of operations.

Special Deposits: This fund acts in a fiduciary capacity in order to account for moneys received with specified purposes for which the law does not specify its recording in any other fund. It mainly includes deposits under the custody of the courts of justice for alimony payments.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Fiduciary Net Assets – Pension Trust Funds

June 30, 2007

(In thousands)

		Pension Trust Funds			
Assets		**Employees' Retirement System (ERS)**	**Teachers' Retirement System (TRS)**	**Judiciary Retirement System (JRS)**	**Total**
Cash and cash equivalents in commercial banks and U.S. Treasury	$	41,365	33,542	2,735	77,642
Cash and cash equivalents in governmental banks:					
Unrestricted		266,633	3,123	197	269,953
Restricted		2,310		—	2,310
Investments:					
Debt equity securities, at fair value		1,842,783	2,686,485	89,382	4,618,650
Other		47,784	46,686	—	94,470
Receivables, net:					
Accounts		119,890	—	—	119,890
Loans and advances		577,314	364,121	256	941,691
Accrued interest and dividends		3,119	6,312	237	9,668
Due from (to) other pension trust funds		5,113	—	(5,113)	—
Due from general fund		4,615	—	—	4,615
Other		4,527	26,882	230	31,639
Capital assets, net		8,476	25,890	—	34,366
Other assets		7,371	700	—	8,071
Total assets		2,931,300	3,193,741	87,924	6,212,965
Liabilities					
Accounts payable and accrued liabilities		38,233	31,017	6,451	75,701
Other liabilities		1,566	4	—	1,570
Total liabilities		39,799	31,021	6,451	77,271
Net Assets					
Net assets held in trust for pension and other benefits	$	2,891,501	3,162,720	81,473	6,135,694

See accompanying independent auditors' report.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Changes in Fiduciary Net Assets – Pension Trust Funds

Year ended June 30, 2007

(In thousands)

	Pension Trust Funds			
	Employees' Retirement System (ERS)	Teachers' Retirement System (TRS)	Judiciary Retirement System (JRS)	Total
Additions:				
Contributions:				
Sponsor	$ 374,394	116,320	6,632	497,346
Participants	338,791	127,809	2,828	469,428
Special	86,097	70,356	—	156,453
Total contributions	799,282	314,485	9,460	1,123,227
Interest and investment income:				
Interest	68,231	65,367	1,447	135,045
Dividends	14,494	13,654	224	28,372
Net change in fair value of investments	364,185	406,131	12,438	782,754
Investment expenses	(12,940)	(6,217)	(192)	(19,349)
Net interest and investment income	433,970	478,935	13,917	926,822
Other income	19,872	1,299	—	21,171
Total additions	1,253,124	794,719	23,377	2,071,220
Deductions:				
Pension and other benefits	831,658	410,562	13,461	1,255,681
Refunds of contributions	33,305	5,447	38	38,790
General and administrative	37,991	22,877	1,255	62,123
Total deductions	902,954	438,886	14,754	1,356,594
Net change in net assets held in trust for pension and other benefits	350,170	355,833	8,623	714,626
Net assets held in trust for pension and other benefits:				
Beginning of year	2,541,331	2,806,887	72,850	5,421,068
End of year	$ 2,891,501	3,162,720	81,473	6,135,694

See accompanying independent auditors' report.

COMMONWEALTH OF PUERTO RICO

Statement of Changes in Assets and Liabilities – Agency Fund

Year ended June 30, 2007

(In thousands)

Assets		**Balance June 30, 2006**	**Additions**	**Deletions**	**Balance June 30, 2007**
Cash and cash equivalents in commercial banks and U.S. Treasury	$	583,196	70,114	—	653,310
Cash and cash equivalents in governmental banks		46,984	3,501,221	3,358,751	189,454
Investments		27,013	—	11,407	15,606
Total assets	$	657,193	3,571,335	3,370,158	858,370
Liabilities					
Accounts payables and accrued liabilities	$	657,193	4,277,726	4,076,549	858,370
Total liabilities	$	657,193	4,277,726	4,076,549	858,370

See accompanying independent auditors' report.

NONMAJOR COMPONENT UNITS

These entities are presented because the nature and significance of their relationship with the primary government are such that their exclusion would cause the basic financial statements to be misleading. These are discretely presented in a separate column in the basic financial statements due to nature of the services they provide. The accounting principles followed by each of the component units included herein may vary depending on the type of industries they are involved in (that is, banking, construction, public utilities, and so forth). The detailed information for each of these entities may be obtained directly from the administrative offices of the corresponding entities, as described in note 1 to the basic financial statements included in the financial section of this report.

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units –
Statement of Net Assets

June 30, 2007

Assets	Agricultural Services and Development Corporation	Automobile Accidents Compensation Administration	Cardiovascular Center Corporation of Puerto Rico and the Caribbean	Caribbean Basin Projects Financing Authority	Culebra Conservation and Development Authority	Economic Development Bank for Puerto Rico	Employment and Training Enterprises Corporation	Farm Insurance Corporation of Puerto Rico	Fine Arts Center Corporation	Governing Board of the 9-1-1 Service	Institute of Puerto Rican Culture	Institutional Trust of the National Guard of Puerto Rico
Assets:												
Current assets:												
Cash and cash equivalents in commercial banks	$ 12	2,210	2,910	—	308	1,984	—	1,692	2,804	—	4,189	—
Cash and cash equivalents in governmental banks	—	5,142	—	4	—	28	9	—	301	21,457	—	66,743
Investments, including collateral from securities lending transactions	—	233,167	—	—	—	177,989	—	—	—	—	—	694
Receivables, net:												
Insurance premium	—	—	—	—	—	—	—	—	—	—	—	—
Intergovernmental	—	—	—	—	—	—	—	—	—	—	—	—
Accounts	6,365	3,059	20,862	—	—	—	485	2,820	191	4,105	338	—
Loans and advances	—	—	—	—	—	57,334	—	—	—	—	—	—
Accrued interest	—	1,153	—	—	—	10,954	—	—	—	67	—	—
Other governmental entities	18,732	—	—	—	—	—	—	—	1	128	458	—
Other	236,626	3,457	1,243	—	—	—	—	—	—	—	—	5,476
Due from:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	—
Component units	—	—	—	—	—	—	—	13,257	—	—	—	—
Inventories	14,735	—	2,638	—	—	—	341	—	—	31	1,502	—
Prepaids	629	—	419	—	—	—	—	324	161	—	—	—
Total current assets	277,099	248,188	28,072	4	308	248,289	835	18,093	3,458	25,788	6,487	72,913
Noncurrent assets:												
Restricted assets:												
Cash and cash equivalents in commercial banks	2	245	500	—	—	—	1,025	4,036	410	—	14,061	—
Cash and cash equivalents in governmental banks	—	—	—	—	—	—	703	—		20,247	4,739	3,000
Investments and other restricted assets	—	—	—	—	—	—	—	—	1,138	—	—	—
Investments	—	—	—	—	—	712,610	—	—	2,592	—	—	—
Receivables:												
Loans, interest and other	—	—	—	—	—	112,796	—	—	—	—	—	—
Interest-bearing deposits with other banks	—	—	—	—	—	—	—	—	—	—	—	—
Other governmental entities	—	—	—	—	—	—	—	—		—	—	—
Other	—	—	—		—				—	—	—	—
Due from:												
Component units	—	—	—	—	—	—	—	—	—	—	—	—
Property held for sale and future development			—				—	—	—	—	—	—
Capital assets, not being depreciated	6,817	901	5,024	—	640	—	—	—	3,100	—	14,121	5,483
Capital assets, depreciable, net	28,650	8,882	6,650	—	434	10,200	325	219	14,759	4,422	73,267	4,461
Deferred expenses and other assets	543	37	—	—	—	4,592	—	—	—	—	—	2,059
Total noncurrent assets	36,012	10,065	12,174	—	1,074	840,198	2,053	4,255	21,999	24,669	106,188	15,003
Total assets	$ 313,111	258,253	40,246	4	1,382	1,088,487	2,888	22,348	25,457	50,457	112,675	87,916

See accompanying independent auditors' report.

(Continued)

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units –
Statement of Net Assets

June 30, 2007

Assets	Land Authority of Puerto Rico	Musical Arts Corporation	National Parks Company of Puerto Rico	Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	Puerto Rico Conservatory of Music Corporation	Puerto Rico Convention Center District Authority	Puerto Rico Council on Higher Education	Puerto Rico Industrial Development Company	Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	Puerto Rico Land Administration	Puerto Rico Medical Services Administration	Puerto Rico Metropolitan Bus Authority
Assets:												
Current assets:												
Cash and cash equivalents in commercial banks	2,700	2,009	—	—	257	20,818	—	39,295	—	612	—	800
Cash and cash equivalents in governmental banks	47,039	—	3,253	549	—	1,078	1,670	37,337	8,547	79,837	—	6
Investments, including collateral from securities lending transactions	—	—	—	139,930	—	—	—	—	—	29,677	—	—
Receivables, net:												
Insurance premium	—	—	—	—	—	—	—	—	—	—	—	
Intergovernmental	—	—	—	—	—	—	—	—	—	—	—	2,422
Accounts	12,428	89	1,159	—	—	13,876	102	23,612	—	5,392	9,174	—
Loans and advances	546	—	—	—	—	—	—	473	—	—	947	—
Accrued interest	736	—	—	2,203	—	—	—	330	33	969	—	—
Other governmental entities	—	361	443	—	71	—	1,000	—	—	—	34,785	—
Other	498	9	—	151	9	78	—	23,293	—	6	—	6,746
Due from:												
Primary government	3,637	—	—	—	14,189	—	—	23,403	—	—	33,983	—
Component units	2,923	—	—	—	—	—	—	—	—	1,305	—	—
Inventories	—	—	—	—	—	—	—	—	—	—	4,331	6,398
Prepaids	—	—	626	—	30	987	—	2,098	—	121	621	—
Total current assets	70,507	2,468	5,481	142,833	14,556	36,837	2,772	149,841	8,580	117,919	83,841	16,372
Noncurrent assets:												
Restricted assets:												
Cash and cash equivalents in commercial banks	647	396	—	—	1,452	—	—	56,854	—	—	2,751	—
Cash and cash equivalents in governmental banks	809	—	22,828	—	—	—	4,577	—	—	400	—	267
Investments and other restricted assets	—	—	—	—	—	82,442	—	—	—	—	—	—
Investments	5,909	—	—	8,964	—	—	—	4,372	—	—	—	—
Receivables:												
Loans, interest and other	994	—	—	—	—	—	—	1,739	—	—	236	—
Interest-bearing deposits with other banks	—	—	—	—	—	5,174	—	—	—	—	—	—
Other governmental entities	—	—	—					—	—	771	—	—
Other	—	—	—	—	—	—	—	481	—	—	—	—
Due from:												
Component units	6,431	—	—	—	—	—	—	—	—	2,611	—	—
Property held for sale and future development	—	—	—	—	—	5,650	—	36,481	—	140,345	—	—
Capital assets, not being depreciated	80,501	153	26,781	—	31,385	238,358	—	268,246	—	23,341	8,131	2,569
Capital assets, depreciable, net	10,890	401	212,389	220	1,761	442,032	374	454,616	—	5,329	43,008	56,307
Deferred expenses and other assets	2	—	—	—	—	16,525	—	3,174	—	—	—	—
Total noncurrent assets	106,183	950	261,998	9,184	34,598	790,181	4,951	825,963	—	172,797	54,126	59,143
Total assets	176,690	3,418	267,479	152,017	49,154	827,018	7,723	975,804	8,580	290,716	137,967	75,515

See accompanying independent auditors' report.

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units –
Statement of Net Assets

June 30, 2007

Assets	Puerto Rico Municipal Finance Agency	Puerto Rico Ports Authority	Puerto Rico Public Broadcasting Corporation	Puerto Rico School of Plastic Arts	Puerto Rico Solid Waste Authority	Puerto Rico Telephone Authority	Puerto Rico Tourism Company	Puerto Rico Trade and Export Company	Right to Employment Administration	Special Communities Perpetual Trust	State Insurance Fund Corporation	Total
Assets:												
Current assets:												
Cash and cash equivalents in commercial banks	—	1,621	4,024	—	—	—	36,613	3,248	—	—	3,281	131,387
Cash and cash equivalents in governmental banks	3,464	103	—	204	348	579	—	3,613	2,905	—	230,982	515,198
Investments, including collateral from securities lending transactions	244,319	—	—	—	2,843		57,072	—	—	—	793,596	1,679,287
Receivables, net:												
Insurance premium	—	—	—	—	—	—	—	—	—	—	108,709	108,709
Intergovernmental	—	—	—	—	—	—	—	—	—	—	—	2,422
Accounts	—	81,005	441	765	2,510	—	6,213	364	—	—	—	195,355
Loans and advances	—	—	—	—	—	—	—	—	—	—	—	59,300
Accrued interest	—	—	—	—	—	—	—	3,795	—	3,736	9,511	33,487
Other governmental entities	—	—	276	—	—	—	—	87	4,035	—	—	60,377
Other	—	—	559	—	—	—	807	—	27	146	15,899	295,030
Due from:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	75,212
Component units	—	—	—	—	—	—	—	—	—	—	3,500	20,985
Inventories	—	320	—	—	—	—	—	—	—	—	7,759	38,055
Prepaids	—	6,030	84	—	158	—	4	2,521	—	—	—	14,813
Total current assets	247,783	89,079	5,384	969	5,859	579	100,709	13,628	6,967	3,882	1,173,237	3,229,617
Noncurrent assets:												
Restricted assets:												
Cash and cash equivalents in commercial banks	4,439	29,316	2,626	139	—	—	—	12,370	—	—	—	131,269
Cash and cash equivalents in governmental banks	—	46,227	—	216	5,561	15,275	—	12,177	380	455,315	—	592,721
Investments and other restricted assets	1,596,263	—	—	865		1,850	—	250,000	3,076	—	—	1,935,634
Investments	—	1,000	—	—	12,452	—	34,733	—	—	—	781,816	1,564,448
Receivables:												
Loans, interest and other	—	—	—	—	—	131	—	218	—	3,742	—	119,856
Interest-bearing deposits with other banks	—	—	—	—	—	—	—	—	—	—	—	5,174
Other governmental entities	—	30,846	—	—	—	—	—	—	—	—	—	31,617
Other	—	—	—	—	—	—	—	—	—	—	—	481
Due from:												
Component units	—		—	—	—	—	—	—	—	—	—	9,042
Property held for sale and future development	—	—	—		—	—	—	—	—	—	—	182,476
Capital assets, not being depreciated	—	422,981	708	—	41,952	—	14,235	69,708	—	—	13,010	1,278,145
Capital assets, depreciable, net	—	418,653	21,521	8,595	140,864	—	25,628	45,294	399	—	93,937	2,134,487
Deferred expenses and other assets	45	9,663	215	—	—	—	21,866	4	—	—	—	58,725
Total noncurrent assets	1,600,747	958,686	25,070	9,815	200,829	17,256	96,462	389,771	3,855	459,057	888,763	8,044,075
Total assets	1,848,530	1,047,765	30,454	10,784	206,688	17,835	197,171	403,399	10,822	462,939	2,062,000	11,273,692

See accompanying independent auditors' report.

(Continued)

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units –
Statement of Net Assets

June 30, 2007

Liabilities and Net Assets	Agricultural Services and Development Corporation	Automobile Accidents Compensation Administration	Cardiovascular Center Corporation of Puerto Rico and the Caribbean	Caribbean Basin Projects Financing Authority	Culebra Conservation and Development Authority	Economic Development Bank for Puerto Rico	Employment and Training Enterprises Corporation	Farm Insurance Corporation of Puerto Rico	Fine Arts Center Corporation	Governing Board of the 9-1-1 Service	Institute of Puerto Rican Culture	Institutional Trust of the National Guard of Puerto Rico
Liabilities:												
Current liabilities:												
Accounts payable and accrued liabilities	$ 247,996	7,609	22,755	4	27	—	1,792	783	284	2,022	7,755	1,379
Deposits and escrow liabilities	—	—	—	—	—	287,867	—	—	125	—	—	—
Due to:												
Primary government	—	—	44,074	—	—	—	—	—	—	5,515	—	—
Component units	16,180	—	7,192	—	—	352	—				—	—
Other governmental entities	7,677	—	—	—	—	—	—	—	—	—	—	—
Securities lending transactions and reverse repurchase agreements	—	58,981	—	—	—	149,878	—	—	—	—	—	—
Interest payable	—	—	—	—	—	8,421	—	—	—	—	—	—
Deferred revenue	—	36,376	—	—	26	—	—	5,232	808	—	—	—
Notes payable, current portion	9,833	—	—	—	—	—	—	—	—	—	—	—
Commonwealth appropriation bonds, current portion	—	—	—	—		—	—	—	—	—	—	—
Bonds payable, current portion	—	—	—	—	—	—	—	—	—	—	—	—
Accrued compensated absences	10,205	4,206	2,474	—	79	—	266	414	49	755	338	105
Workers compensation claims	—	—	—	—	—	—	—	—	—	—	—	—
Liability for automobile accident benefit payments	—	118,273	—	—	—	—	—	—	—	—	—	—
Current portion of other long-term liabilities	236	—	273	—	—	3,410	—	—	—	—	—	—
Total current liabilities	292,127	225,445	76,768	4	132	449,928	2,058	6,429	1,266	8,292	8,093	1,484
Noncurrent liabilities:												
Due to:												
Primary government	—	—	—	—	—	—	7,108	—	—	—	—	—
Component units	127,578	—	—	—	—	11,524	—	6,431	—	—	22,756	—
Deferred revenue	—	—	—	—	—	—	788	—	—	—	—	—
Notes payable	—	—	—	—	—	500,000	—	—	—	—	—	—
Commonwealth appropriation bonds	—	—	—	—	—	—	—	—	—	—	—	—
Bonds payable	—	—	—	—	—	—		—	—	—	—	—
Compensated absences	—	—	—	—	72	2,310	—	—	575	—	3,311	
Other long-term liabilities	287	—	1,374	—	—	788	—	—	—	—	—	—
Total noncurrent liabilities	127,865	—	1,374	—	72	514,622	7,896	6,431	575	—	26,067	—
Total liabilities	419,992	225,445	78,142	4	204	964,550	9,954	12,860	1,841	8,292	34,160	1,484
Net assets:												
Invested in capital assets, net of related debt	—	9,783	11,674	—	1,074	(1,675)	325	219	17,353	4,352	62,792	9,943
Restricted for:												
Capital projects	—	—	500	—	—	—	—	—	1,548	—	5,747	—
Debt service	—	—	—	—	—	—	—	—	—	—	—	—
Affordable housing and related loan insurance programs	—	—	—	—	—	—	—	—	—	—	—	—
Student loans and other educational purposes	—	—	—	—	—	—	—	—	—	—	—	500
Other specified purposes	—	245	—	—	—	9,665	—	4,036	—	20,247	8,065	2,500
Unrestricted (deficit)	(106,881)	22,780	(50,070)	—	104	115,947	(7,391)	5,233	4,715	17,566	1,911	73,489
Total net assets (deficit)	(106,881)	32,808	(37,896)	—	1,178	123,937	(7,066)	9,488	23,616	42,165	78,515	86,432
Total liabilities and net assets (deficit)	$ 313,111	258,253	40,246	4	1,382	1,088,487	2,888	22,348	25,457	50,457	112,675	87,916

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units –
Statement of Net Assets

June 30, 2007

Liabilities and Net Assets	Land Authority of Puerto Rico	Musical Arts Corporation	National Parks Company of Puerto Rico	Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	Puerto Rico Conservatory of Music Corporation	Puerto Rico Convention Center District Authority	Puerto Rico Council on Higher Education	Puerto Rico Industrial Development Company	Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	Puerto Rico Land Administration	Puerto Rico Medical Services Administration	Puerto Rico Metropolitan Bus Authority
Liabilities:												
Current liabilities:												
Accounts payable and accrued liabilities	61,587	1,505	7,308	12,886	2,711	8,200	303	54,689	100	3,077	81,319	12,459
Deposits and escrow liabilities	10,647	—	—	—	—	3,083	—	4,034	—	1,405	—	—
Due to:												
Primary government	—	—	—	—	—	—	—	—	—	—	43,070	—
Component units	36,741		3,830	—	—	155,221	—	82,380	—	—	44,054	—
Other governmental entities	260	—	2,265	—	—	—	—	—	—	—	12,212	—
Securities lending transactions and reverse repurchase agreements	—	—	—	—	—	—	—	—	—	—	—	—
Interest payable	3,576	—	592	—	316	33,393	—	8,586	—	—	—	252
Deferred revenue	—	1,097	—	—	—	5,395	—	4,555	—	—	—	191
Notes payable, current portion	2,121	—	—		—	—	—	4,382	—	—	—	4,720
Commonwealth appropriation bonds, current portion	613	—		—	—	—	—	—	—	—	—	—
Bonds payable, current portion	—		—	—	—	3,000	—	6,992	—	—	—	—
Accrued compensated absences	1,359	137	222	1,110	165	294	—	5,672	—	—	8,719	3,598
Workers compensation claims	—	—	—	—	—	—	—	—	—	—	—	—
Liability for automobile accident benefit payments	—	—	—	—	—	—	—	—	—	—	—	—
Current portion of other long-term liabilities	3,063	—	6,420	—	—	—		74	—	—	496	—
Total current liabilities	119,967	2,739	20,637	13,996	3,192	208,586	303	171,364	100	4,482	189,870	21,220
Noncurrent liabilities:												
Due to:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	—
Component units	—	—	—	—	—	—	—	2,611	—	—	—	—
Deferred revenue	—	—	—	—	—	5,318	—	11,284	—	—	—	—
Notes payable	4,241	—	—	—	—	—	—	92,099	—	—	—	40,850
Commonwealth appropriation bonds	162,003	—	—	—	—	—	—	—	—	—	—	—
Bonds payable	—	—	—	—	—	478,722	—	274,143	—	—	—	—
Compensated absences	—	25	5,856	—	753	—	315	—	—	799	—	—
Other long-term liabilities	—	2,442	976	—	1,065	—	—	85	—	38,342	7,068	5,640
Total noncurrent liabilities	166,244	2,467	6,832	—	1,818	484,040	315	380,222	—	39,141	7,068	46,490
Total liabilities	286,211	5,206	27,469	13,996	5,010	692,626	618	551,586	100	43,623	196,938	67,710
Net assets:												
Invested in capital assets, net of related debt	91,341	554	234,749	220	33,146	44,956	374	341,171	—	28,670	47,543	58,877
Restricted for:												
Capital projects	809	—	—	—	10,095	35,851	—		—	—	—	267
Debt service	—	—	—	—	—	32,482	—	45,404	—	—	—	—
Affordable housing and related loan insurance program	—	—	—	—		—	—	—	—	—	—	—
Student loans and other educational purposes	—	—	—	—	903	—	5,461	—	—	—	—	—
Other specified purposes	—	396	—	61,700	—	—	1,171	—	—	400	3	—
Unrestricted (deficit)	(201,671)	(2,738)	5,261	76,101	—	21,103	99	37,643	8,480	218,023	(106,517)	(51,339)
Total net assets (deficit)	(109,521)	(1,788)	240,010	138,021	44,144	134,392	7,105	424,218	8,480	247,093	(58,971)	7,805
Total liabilities and net assets (deficit)	176,690	3,418	267,479	152,017	49,154	827,018	7,723	975,804	8,580	290,716	137,967	75,515

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units –
Statement of Net Assets

June 30, 2007

Liabilities and Net Assets	Puerto Rico Municipal Finance Agency	Puerto Rico Ports Authority	Puerto Rico Public Broadcasting Corporation	Puerto Rico School of Plastic Arts	Puerto Rico Solid Waste Authority	Puerto Rico Telephone Authority	Puerto Rico Tourism Company	Puerto Rico Trade and Export Company	Right to Employment Administration	Special Communities Perpetual Trust	State Insurance Fund Corporation	Total
Liabilities:												
Current liabilities:												
Accounts payable and accrued liabilities	1,585	116,876	2,626	761	13,910	17	47,235	6,339	9,111	41,156	164,871	943,037
Deposits and escrow liabilities	231,428	1,294	—	—	—	—	—	—	—	—	—	539,883
Due to:												
Primary government	—	—	—	—	—	—	22,178	—	—	—	—	114,837
Component units	—	—	—	—	18,500	—	—	—	—	—	—	364,450
Other governmental entities	—	—	—	—	—	—	—	—	839	—	—	23,253
Securities lending transactions and reverse repurchase agreements	—	—	—	—	—	—	—	—	—	—	149,018	357,877
Interest payable	31,357	2,133	—	—	—	—	—	3,170	—	35,317	—	127,113
Deferred revenue	—	367	276	—	—		—	—	53	—	48,064	102,440
Notes payable, current portion	—	127,091	—		—	—	—	—	—	—	2,278	150,425
Commonwealth appropriation bonds, current portion	—	—	—	—	—	—	1,916	—	—	—	—	2,529
Bonds payable, current portion	99,035	4,855	—	—	—	—	—	—	—	—	—	113,882
Accrued compensated absences	—	5,582	961	37	456	—	2,025	1,861	1,572	—	45,760	98,421
Workers compensation claims	—	—	—	—	—	—	—	—	—	—	687,829	687,829
Liability for automobile accident benefit payments	—	—	—	—	—	—	—	—	—	—	—	118,273
Current portion of other long-term liabilities	—	12,012	—	—	—	10,801	129	—	—	—	375	37,289
Total current liabilities	363,405	270,210	3,863	798	32,866	10,818	73,483	11,370	11,575	76,473	1,098,195	3,781,538
Noncurrent liabilities:												
Due to:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	7,108
Component units	—	2,750	—	—	44,497	—	—	—	—	385,152	—	603,299
Deferred revenue	—	4,147	—	—	—	—	—	—	—	—	—	21,537
Notes payable	—	423,810	—	—	—	—	—	250,000	—	—	49,358	1,360,358
Commonwealth appropriation bonds	—	—		—	7,701	—	124,202	—	—	—	—	293,906
Bonds payable	1,398,908	57,009	—	—	—	—	—	—	—	—	—	2,208,782
Compensated absences	—	—	1,503	290	557	—	2,462	—	1,368	—	—	20,196
Other long-term liabilities	16,345	318	—	—	—	—	535	3,795	—	—	84,224	163,284
Total noncurrent liabilities	1,415,253	488,034	1,503	290	52,755	—	127,199	253,795	1,368	385,152	133,582	4,678,470
Total liabilities	1,778,658	758,244	5,366	1,088	85,621	10,818	200,682	265,165	12,943	461,625	1,231,777	8,460,008
Net assets:												
Invested in capital assets, net of related debt	—	318,340	22,229	8,595	110,148	—	39,604	115,002	399	—	22,391	1,634,149
Restricted for:												
Capital projects	—	41,816	1,131	—	2,166	—	—	—	—	—	—	99,930
Debt service	55,057	18,264	—	—	—	—	—	—	—	—	—	151,207
Affordable housing and related loan insurance programs	—	—	—	—	—	—	—	—	—	417,927	—	417,927
Student loans and other educational purposes	—	—	—	865	—	—	—	—	—	—	—	7,729
Other specified purposes	—	3,409	1,220	—	—	6,455	—	500	—	—	—	120,012
Unrestricted (deficit)	14,815	(92,308)	508	236	8,753	562	(43,115)	22,732	(2,520)	(416,613)	807,832	382,730
Total net assets (deficit)	69,872	289,521	25,088	9,696	121,067	7,017	(3,511)	138,234	(2,121)	1,314	830,223	2,813,684
Total liabilities and net assets (deficit)	1,848,530	1,047,765	30,454	10,784	206,688	17,835	197,171	403,399	10,822	462,939	2,062,000	11,273,692

COMMONWEALTH OF PUERTO RICO

Nonmajor Discretely Presented Component Units –
Statement of Activities

Year ended June 30, 2007

(In thousands)

Component units	Expenses	Program revenues: Charges for services	Program revenues: Operating grants and contributions	Program revenues: Capital grants and contributions	Net revenues (expenses) and changes in net assets	General revenues: Payments from Primary government	General revenues: Payments from (to) other component units	General revenues: Contributions not restricted to specific programs	General revenues: Taxes	General revenues: Interest and investment earnings	General revenues: Gain in sale of assets	General revenues: Miscellaneous	Change in net assets	Net assets, beginning of year (as restated)	Net assets, end of year
Nonmajor:															
Agricultural Services and Development Corporation	170,304	72,858	—	—	(97,446)	97,415	—	—	—	—	—	824	793	(107,674)	(106,881)
Automobile Accidents Compensations Administration	109,068	79,708	—	—	(29,360)	—	—	—	—	24,943	—	—	(4,417)	37,225	32,808
Cardiovascular Center Corporation of Puerto Rico and the Caribbean	75,108	67,310	—	—	(7,798)	2,500	—		—	291	—	—	(5,007)	(32,889)	(37,896)
Caribbean Basin Projects Financing Authority	103	—	—	—	(103)	—	—		—	4	—	—	(99)	99	—
Culebra Conservation and Development Authority	848	240	10	—	(598)	589	—	—	—	—	—	—	(9)	1,187	1,178
Economic Development Bank for Puerto Rico	66,482	66,794	—	—	312	—		—	—	4,725	—	—	5,037	118,900	123,937
Employment and Training Enterprises Corporation	3,680	2,338	210	—	(1,132)	—	—	—	—	95	—	5	(1,032)	(6,034)	(7,066)
Farm Insurance Corporation of Puerto Rico	8,169	9,102	2,003	—	2,936	—	—	—	—	247	—	98	3,281	6,207	9,488
Fine Arts Center Corporation	5,528	2,410	—	—	(3,118)	5,403		—	—	267	—	—	2,552	21,064	23,616
Governing Board of the 911 Service	17,728	21,292	—	—	3,564	—		—	—	1,934	—	497	5,995	36,170	42,165
Institute of Puerto Rican Culture	26,794	—	—	369	(26,425)	23,860	—	—	—	—	—	—	(2,565)	81,080	78,515
Institutional Trust of the National Guard of Puerto Rico	8,595	19,708	—	—	11,113	—	—	—	—	3,100	—	—	14,213	72,219	86,432
Land Authority of Puerto Rico	35,785	29,106	—	—	(6,679)	—	9,690	—	6,697	1,845	—	5,441	16,994	(126,515)	(109,521)
Musical Arts Corporation	8,264	449	892	—	(6,923)	5,530	—	—	210	—	—	345	(838)	(950)	(1,788)
National Parks Company of Puerto Rico	45,320	12,935	—		(32,385)	24,635	—	—	—	1,742	—	306	(5,702)	245,712	240,010
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	9,543	12,789	—	629	3,875	—	—	—	—	7,972	—	—	11,847	126,174	138,021
Puerto Rico Conservatory of Music Corporation	7,319	2,322	78	—	(4,919)	4,571	—		—	12	—	—	(336)	44,480	44,144
Puerto Rico Convention Center District Authority	82,047	28,508	—	—	(53,539)	39,500	—	—	30,582	4,718	—	796	22,057	112,335	134,392
Puerto Rico Council on Higher Education	34,231	183	3,789	—	(30,259)	27,091	—		—	581	—	47	(2,540)	9,645	7,105
Puerto Rico Industrial Development Company	86,259	64,231	—	207	(21,821)	3,434	—		—	6,558	21,370	—	9,541	414,677	424,218
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental, Control Facilities Financing Authority	61	—	—	—	(61)	—	—		—	389	—	—	328	8,152	8,480
Puerto Rico Land Administration	9,978	9,338	—	—	(640)	1	—	—	—	5,745	—	282	5,388	241,705	247,093
Puerto Rico Medical Services Administration	164,675	112,784	—	—	(51,891)	38,460	—	—	—	838	1,886	—	(10,707)	(48,264)	(58,971)
Puerto Rico Metropolitan Bus Authority	83,070	31,665	13,262	—	(38,143)	26,761	—	—	—	7	—	—	(11,375)	19,180	7,805
Puerto Rico Municipal Finance Agency	86,697	—	—	—	(86,697)	—	—	—	—	96,375	—	—	9,678	60,194	69,872
Puerto Rico Ports Authority	195,389	146,368	—	14,413	(34,608)	—	—	—	—	2,335	—	25,771	(6,502)	296,023	289,521
Puerto Rico Public Broadcasting Corporation	29,737	1,820	—	—	(27,917)	25,295		3,068	—	400	—	521	1,367	23,721	25,088
Puerto Rico School of Plastic Arts	5,959	911	1,221	—	(3,827)	3,503	—	—	—	100	—	—	(224)	9,920	9,696
Puerto Rico Solid Waste Authority	22,885	1,105	—	—	(21,780)	40,017	992	—	—	1,114	—	107	20,450	100,617	121,067
Puerto Rico Telephone Authority	502	—	—	—	(502)	—	—	—	—	516	—	—	14	7,003	7,017
Puerto Rico Tourism Company	324,337	323,293	—	—	(1,044)	3,033	(62,615)		21,347	8,161	2,413	—	(28,705)	25,194	(3,511)
Puerto Rico Trade and Export Company	44,785	17,239	—	4,775	(22,771)	9,744	—		—	19,991	—	143	7,107	131,127	138,234
Right to Employment Administration	29,886	—	16,283	—	(13,603)	13,677	—	—	—	332	—	—	406	(2,527)	(2,121)
Special Communities Perpetual Trust	155,844	—	—	—	(155,844)	50,326	—	—	—	27,744	—	—	(77,774)	79,088	1,314
State Insurance Fund Corporation	666,126	653,405	—	—	(12,721)	—	—	—	—	129,061	—	—	116,340	713,883	830,223
Total nonmajor component units	$ 2,621,106	1,790,211	37,748	20,393	(772,754)	445,345	(51,933)	3,068	58,836	352,142	25,669	35,183	95,556	2,718,128	2,813,684

See accompanying independent auditors' report.

STATISTICAL SECTION

STATISTICAL SECTION

This part of the Commonwealth of Puerto Rico's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the Commonwealth's overall financial health.

Contents	Pages
Financial Trends	1 – 4

These schedules contain trend information to help the reader understand how the Commonwealth's financial performance and well-being have changed over time.

Revenue Capacity	5

This schedule contains information to help the reader assess the Commonwealth's most significant local revenue sources.

Debt Capacity	6 – 7

These schedules present information to help the reader assess the affordability of the Commonwealth's current levels of outstanding debt and the Commonwealth's ability to issue additional debt in the future.

Demographic and Economic Information	8 – 10

These schedules offer demographic and economic indicators to help the reader understand the environment within which the Commonwealth's financial activities take place.

Operating Information	11

This schedule contains service data to help the reader understand how the information in the Commonwealth's financial report relates to the services the government provides and the activities it performs.

Sources: Unless otherwise noted, the information in these schedules is derived from the comprehensive annual financial reports for the relevant year.

COMMONWEALTH OF PUERTO RICO

Changes in Net Assets (Unaudited)

Last Four Fiscal Years

Accrual Basis of Accounting

(In thousands)

	2007	2006	2005	2004
Expenses:				
Governmental activities:				
General government	$ 2,847,596	2,844,494	1,827,816	1,963,879
Public safety	1,983,782	2,217,294	2,580,951	1,950,635
Health	1,943,582	1,422,813	2,364,110	2,386,735
Public housing and welfare	3,157,877	3,287,559	3,443,886	2,919,315
Education	4,748,008	4,110,669	5,000,686	3,684,331
Economic development	554,271	564,447	1,006,945	896,925
Intergovernmental	593,264	440,390	—	591,237
Interest and other	863,723	882,163	845,556	778,700
Total governmental activities	16,692,103	15,769,829	17,069,950	15,171,757
Business-type activities:				
Lotteries	679,274	670,425	699,407	731,344
Unemployment	192,484	207,483	197,967	142,652
Other	26,860	25,043	32,437	26,763
Total business-type activities	898,618	902,951	929,811	900,759
Total primary government expenses	17,590,721	16,672,780	17,999,761	16,072,516
Program revenue:				
Governmental activities:				
Charges for services	757,724	828,993	702,691	769,207
Operating grants and contributions	4,773,174	4,365,711	4,096,204	1,038,776
Capital grants and contributions	257,514	100,990	121,083	2,592,055
Total governmental activities	5,788,412	5,295,694	4,919,978	4,400,038
Business activities:				
Charges for services	1,140,539	1,149,426	1,187,009	1,136,705
Operating grants and contributions	43,480	59,613	22,315	59,728
Total business-type activities	1,184,019	1,209,039	1,209,324	1,196,433
Net (expense) revenue:				
Governmental activities	(10,903,691)	(10,474,135)	(12,149,972)	(10,771,719)
Business-type activities	285,401	306,088	279,513	295,674
Total primary government net expense	$ (10,618,290)	(10,168,047)	(11,870,459)	(10,476,045)
General revenue:				
Governmental activities:				
Taxes:				
Income	$ 6,488,211	6,255,391	5,526,006	5,191,080
Excise	1,475,311	2,013,998	2,101,216	1,924,610
Sales and use tax	583,639	—	—	—
Other	4,663	15,145	7,128	19,211
Revenue from global settlement agreement	69,604	66,796	106,521	70,420
Unrestricted investment earnings	176,674	117,080	116,686	60,585
Revenue from component units	311,732	68,745	474,069	175,729
Grants and contributions not restricted to specific programs	135,916	196,721	102,691	5,706
Payment from agency fund	—	—	—	—
Special item	—	(2,485)	—	(35,646)
Gain on sale of assets	—	19,588	—	—
Transfers	342,743	242,642	492,796	203,258
Other	71,187	203,525	322,185	384,719
Total governmental activities	9,659,680	9,197,146	9,249,298	7,999,672
Business-type activities:				
Unrestricted investments earnings	37,177	33,165	32,284	23,831
Revenue from component units	—	—	—	—
Grants and contributions not restricted to specific programs	—	—	—	—
Transfers	(342,743)	(242,642)	(492,796)	(203,258)
Total business-type activities	(305,566)	(209,477)	(460,512)	(179,427)
Total primary government	9,354,114	8,987,669	8,788,786	7,820,245
Change in net assets:				
Governmental activities	(1,244,011)	(1,276,989)	(2,900,674)	(2,772,047)
Business-type activities	(20,165)	96,611	(180,999)	116,247
Total primary government	$ (1,264,176)	(1,180,378)	(3,081,673)	(2,655,800)

COMMONWEALTH OF PUERTO RICO

Net Assets by Component (Unaudited)

Last Four Fiscal Years

Accrual Basis of Accounting

(In thousands)

	2007	2006	2005	2004
Governmental activities:				
Invested in capital assets, net of related debt	$ 3,635,271	3,485,882	3,774,098	3,133,230
Restricted	331,051	280,078	296,692	—
Unrestricted deficit	(22,405,216)	(20,975,523)	(19,987,579)	(16,789,576)
Total governmental activities net assets	(18,438,894)	(17,209,563)	(15,916,789)	(13,656,346)
Business-type activities:				
Invested in capital assets, net of related debt	674	1,008	847	1,672
Restricted	910,479	947,507	872,215	853,194
Unrestricted deficit	(153,818)	(171,015)	(202,212)	(3,037)
Total business-type activities net assets	757,335	777,500	670,850	851,829
Primary government:				
Invested in capital assets, net of related debt	3,635,945	3,486,890	3,774,945	3,134,902
Restricted	1,241,530	1,227,585	1,168,907	853,194
Unrestricted deficit	(22,559,034)	(21,146,538)	(20,189,791)	(16,792,613)
Total primary government net assets	$ (17,681,559)	(16,432,063)	(15,245,939)	(12,804,517)

COMMONWEALTH OF PUERTO RICO

Changes in Fund Balances of Governmental Funds (Unaudited)

All Governmental Fund Types

Last Ten Fiscal Years

(In thousands)

	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Revenue:										
Taxes:										
Income	$ 6,389,973	6,181,995	5,564,673	5,061,761	4,874,795	4,843,852	4,536,840	4,967,138	4,413,860	3,989,239
Excise	1,475,311	2,013,998	2,101,216	1,924,610	1,894,729	1,713,098	1,788,992	1,736,539	1,714,444	1,884,348
Sales and use tax	583,639	—	—	—	—	—	—	—	—	—
Other	4,663	15,145	7,128	19,211	3,055	1,963	92,024	87,523	78,926	73,426
Charges for services	757,724	828,993	702,691	750,978	780,905	535,423	645,806	617,020	457,454	569,096
Intergovernmental	5,166,604	4,663,422	4,319,977	3,654,766	4,107,706	3,634,358	3,807,049	2,971,528	3,417,647	3,009,169
Interest	176,674	117,080	116,686	58,914	85,565	90,940	67,020	91,525	97,880	116,030
Other	434,024	334,591	869,338	629,426	436,668	839,240	270,711	383,548	162,228	189,476
Total revenue all governmental fund types	14,988,612	14,155,224	13,681,709	12,099,666	12,183,423	11,658,874	11,208,442	10,854,821	10,342,439	9,830,784
Expenditures:										
General government	2,537,999	2,489,093	1,675,428	1,777,365	1,774,156	1,279,750	739,009	853,040	526,629	484,547
Public safety	1,864,256	2,108,152	2,409,668	1,765,199	1,424,846	1,659,280	1,623,362	1,310,322	1,103,606	1,241,762
Health	1,948,201	1,429,888	2,344,522	2,176,741	1,908,717	1,983,727	954,563	972,757	625,475	656,498
Public housing and welfare	3,048,585	3,130,373	3,320,849	2,738,016	2,953,189	2,726,129	2,315,899	2,102,410	2,485,092	1,902,902
Education	4,400,321	4,101,980	4,177,664	3,474,013	3,297,248	3,343,002	2,308,479	2,436,267	2,272,903	2,744,630
Economic development	533,253	516,444	706,066	868,926	428,621	637,794	170,937	337,255	314,897	186,296
Intergovernmental	593,247	409,727	—	528,829	465,699	466,169	222,721	373,016	318,664	55,739
Capital outlays	512,824	502,348	665,630	581,788	1,184,976	507,634	1,020,344	833,597	642,016	1,515,230
Debt service:										
Principal	904,604	446,281	391,554	526,572	330,346	2,062,059	466,467	416,369	351,722	620,866
Interest and other	814,723	822,234	733,931	737,502	1,158,749	614,347	545,001	444,595	442,614	595,053
Total expenditures all governmental fund types	17,158,013	15,956,520	16,425,312	15,174,951	14,926,547	15,279,891	10,366,782	10,079,628	9,083,618	10,003,523
Other financing sources (uses):										
Transfers in	1,918,567	1,423,240	1,745,992	1,034,090	1,664,278	966,935	756,229	1,026,581	992,667	1,116,455
Transfers out	(1,575,824)	(1,180,598)	(1,253,216)	(830,832)	(1,385,218)	(779,752)	(2,864,056)	(2,646,732)	(2,841,330)	(2,156,852)
Long-term debt issued	1,140,356	1,518,355	1,619,562	3,001,116	2,241,190	3,107,821	834,396	474,471	479,610	1,971,960
Discount on bonds issued	—	(323)	(6,078)	(23,061)	(36,204)	(16,075)	—	—	—	—
Capital leases	2,975	4,580	847	2,300	58,897	—	—	—	—	—
Refunding bonds issued	379,498	—	—	2,372,689	1,754,686	1,636,838	329,370	54,645	117,529	631,906
Payment to refunded bond escrow agent	—	—	—	(2,316,910)	(1,754,686)	(1,665,811)	(227,369)	(54,645)	(117,529)	(632,822)
Other	—	54,135	—	—	—	327,785	—	—	—	140,000
Total other financing sources (uses) all governmental fund types	1,865,572	1,819,389	2,107,107	3,239,392	2,542,943	3,577,741	(1,171,430)	(1,145,680)	(1,369,053)	1,070,647
Net change in fund balances (deficit)	$ (303,829)	18,093	(636,496)	164,107	(200,181)	(43,276)	(329,770)	(370,487)	(110,232)	897,908

The annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation, collected by the Municipal Revenue Collection Center on the Commonwealth's behalf, is presented as property tax from 2002 henceforth but as intergovernmental revenue in prior years.

In 2002, the Commonwealth adopted GASB No. 34. This statement requires that component units be included as expenditure by function. In prior years, such payments were reported as operating transfers-out to component units.

COMMONWEALTH OF PUERTO RICO

Fund Balances of Governmental Funds (Unaudited)

Last Four Fiscal Years

Modified-Accrual Basis of Accounting

(In thousands)

		2007	2006	2005	2004
General fund:					
Reserved	$	993,320	770,628	810,314	1,102,232
Unreserved deficit		(1,504,478)	(1,154,383)	(1,321,585)	(1,468,182)
Total general fund	$	(511,158)	(383,755)	(511,271)	(365,950)
All other governmental funds:					
Reserved	$	125,756	73,346	45,546	72,455
Unreserved reported in:					
Debt service funds		131,782	143,732	156,564	119,830
Special revenue funds		137,286	358,452	256,949	449,455
Capital project funds		223,443	219,163	437,923	744,577
Total all other governmental funds	$	618,267	794,693	896,982	1,386,317

COMMONWEALTH OF PUERTO RICO

General Fund Net Revenue for the Last Ten Fiscal Years (Unaudited)

(In thousands)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Administrative measures	$ —	—	—	—	244,097	—	—	—	—	—
Excises on off-shore shipments rum	200,260	217,296	245,750	286,890	314,253	309,958	328,921	341,166	346,272	377,872
Custom duties	72,206	61,355	50,231	43,154	30,595	25,918	34,266	26,731	9,553	14,504
From noninternal revenues	272,466	278,651	295,981	330,044	344,848	335,876	363,187	367,897	355,825	392,376
Miscellaneous	158,568	176,669	169,246	210,665	238,116	314,857	379,501	430,534	331,803	330,064
Transfer from nonbudgeted funds	—	—	—	89,093	80,000	123,600	—	—	—	—
Electronic lottery	54,681	53,013	70,209	70,211	57,897	89,443	86,115	68,011	55,212	71,815
Traditional lottery	57,986	59,206	63,779	57,482	61,358	67,621	65,387	64,638	62,729	73,014
Nontax revenues	271,235	288,888	303,234	427,451	437,371	595,521	531,003	563,183	449,744	474,893
Alcoholic beverages and others	12,572	14,832	14,123	15,182	14,805	13,518	14,200	14,528	14,804	15,179
Entertainment machines	7,327	9,235	10,545	11,322	12,874	13,932	14,393	15,019	16,981	16,930
Motor vehicles	46,268	46,781	49,133	49,834	54,896	58,426	55,638	55,669	59,525	65,501
Licenses	66,167	70,848	73,801	76,338	82,575	85,876	84,231	85,216	91,310	97,610
Others	13,271	17,273	15,194	16,686	64,626	20,539	24,334	29,927	25,681	20,235
Hotel rooms	13,299	15,923	17,275	—	—	9,056	—	—	—	—
5% general excise tax	468,425	520,351	525,561	508,972	486,302	505,709	535,381	557,323	551,723	193,949
Crude oil and derived products	51,636	70,056	24,786	1,901	38,619	12,925	—	—	—	—
Slot machines	12,230	26,330	30,869	—	36,953	90,018	76,966	85,513	23,167	23,128
Cement	1,702	2,417	2,531	2,707	3,426	3,279	3,432	3,228	2,919	2,627
Insurance premiums	19,364	20,368	21,564	22,845	24,290	26,771	27,217	28,324	43,055	39,052
Horse races	27,401	21,405	26,351	18,893	22,033	28,872	28,865	31,463	30,786	29,321
Motor vehicle	350,004	411,573	389,995	406,252	418,024	499,252	551,181	606,662	533,957	396,667
Petroleum products	6,172	5,562	4,689	7,046	5,095	5,860	4,934	5,143	5,146	6,028
Cigarettes	111,094	119,105	115,157	119,135	116,055	149,487	144,733	146,527	135,267	132,399
General taxes, total	1,074,598	1,230,363	1,173,972	1,104,437	1,215,423	1,351,768	1,397,043	1,494,110	1,351,701	843,406
Other beverages	11,619	14,597	16,884	13,101	18,234	17,884	17,428	19,692	18,745	18,932
Beer	178,465	181,348	170,065	177,448	179,737	223,309	217,568	221,902	219,379	207,813
Distilled spirits	48,034	47,519	49,425	46,963	51,734	58,389	61,306	56,641	54,056	52,283
Alcoholic beverages, total	238,118	243,464	236,374	237,512	249,705	299,582	296,302	298,235	292,180	279,028
Excise taxes, total	1,312,716	1,473,827	1,410,346	1,341,949	1,465,128	1,651,350	1,693,345	1,792,345	1,643,881	1,122,434
Sales and use tax	—	—	—	—	—	—	—	—	—	582,560
Inheritance and gift taxes	1,380	1,811	3,109	7,475	1,962	2,825	15,691	7,129	9,466	4,663
Taxes on dividends to 10%	39,616	38,996	39,664	58,580	62,548	49,790	70,192	80,398	66,721	138,859
Interest subject to 17%	11,406	10,666	11,674	14,782	14,310	11,278	10,108	10,489	11,536	12,112
Tollgate tax	170,953	114,533	111,130	49,511	59,515	45,321	31,579	22,973	27,396	25,083
Withholding to nonresidents	192,463	369,384	557,276	696,835	583,256	517,141	631,100	612,005	921,260	933,728
Partnerships	4,404	2,087	2,339	3,026	2,670	2,101	3,005	3,245	2,787	2,960
Corporations	1,527,415	1,653,762	1,781,862	1,696,766	1,706,137	1,776,985	1,831,027	1,870,937	1,872,458	2,002,718
Individuals	2,026,612	2,244,376	2,352,066	2,259,090	2,449,982	2,767,678	2,720,920	2,885,903	3,087,748	3,071,655
Income taxes, total	3,972,869	4,433,804	4,856,011	4,778,590	4,878,418	5,170,294	5,297,931	5,485,950	5,989,906	6,187,115
Property taxes	5,673	2,214	1,131	287	—	—	—	3,949	1,106	800
Tax revenues	5,358,805	5,982,504	6,344,398	6,204,639	6,428,083	6,910,345	7,091,198	7,374,589	7,735,669	7,995,182
From internal revenues	5,630,040	6,271,392	6,647,632	6,632,090	6,865,454	7,505,866	7,622,201	7,937,772	8,185,413	8,470,075
Total	$ 5,902,506	6,550,043	6,943,613	6,962,134	7,454,399	7,841,742	7,985,388	8,305,669	8,541,238	8,862,451

Note: The net revenue presented above include the actual revenue and the operating transfers-in from other funds presented in the combined statement of revenue and expenditures – budget and actual – budget basis.
Source: Puerto Rico Treasury Department.

COMMONWEALTH OF PUERTO RICO

Legal Debt Margin Information (Unaudited)

Last Ten Fiscal Years

(In thousands)

	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Internal revenue average for two years	$ 8,327,744	8,061,593	7,779,987	7,564,034	7,185,660	6,748,772	6,639,861	6,459,512	5,950,716	5,482,960
Legal debt limit – 15% of internal revenue average for two years	1,249,162	1,209,239	1,166,998	1,134,605	1,077,849	1,012,316	995,979	968,927	892,607	822,444
Maximum debt service requirement	719,927	680,742	630,685	598,547	599,611	521,035	588,359	561,918	532,324	533,241
Additional legal debt service requirement margin	—	—	536,313	536,058	478,238	491,281	40,762	407,009	360,283	289,203
Total maximum debt service requirement as a percentage of internal revenue average for two years	8.64%	8.44%	8.11%	7.91%	8.34%	7.72%	8.86%	8.70%	8.95%	9.73%

Legal debt margin calculation for fiscal year 2007:	
Internal revenue for the year ended June 30, 2006	$ 8,185,413
Internal revenue for the year ended June 30, 2007	8,470,075
Total internal revenue for the years ended June 30, 2006 and 2007	$ 16,655,488
Internal revenue average for the two years	$ 8,327,744
Legal debt limit – 15% of internal revenue average for the two years	$ 1,249,162
Maximum debt service requirement	719,927
Additional legal debt service requirement as a percentage of internal revenue average for two years	$ 529,235

Sources: Governmental Development Bank for Puerto Rico General obligation debt service may not exceed 15% of the average of the internal revenues for the last two fiscal years.

COMMONWEALTH OF PUERTO RICO

Ratio of Annual Debt Service for General
Bonded Debt to Total General Expenditures (Unaudited)

Last Ten Fiscal Years

(In thousands)

	Total debt service	Total governmental expenditures	Ratio
Fiscal year:			
2007	$ 606,800	17,158,013	3.5%
2006	565,137	15,849,707	3.6
2005	491;394	16,425,312	3.0
2004	459,336	15,174,951	3.0
2003	362,136	14,926,547	2.4
2002	608,674	15,279,891	4.0
2001	538,436	10,366,782	5.2
2000	507,336	10,079,628	5.0
1999	468,970	9,083,618	5.2
1998	435,894	10,003,523	4.4

COMMONWEALTH OF PUERTO RICO

Demographic and Economic Statistics (Unaudited)

Last Ten Fiscal Years

	Population *	Per capita income	Median age	Life expectancy	School enrollment (r)	Labor force (in thousands)	Unemployment rate	Gross product (current prices $)**	Real gross product (2000 prices $)**
Fiscal year:									
2007	3,941	$ 13,491(p)	34.4	76.8	716,755	1,409	10.4	$ 58,712(p)	$ 44,213(p)
2006	3,928	13,033(r)	34.4	76.8	774,381	1,422(r)	11.7	56,733(r)	45,009(r)
2005	3,912	12,507(r)	34.4	76.8	786,819	1,385	10.6	53,752(r)	44,785(r)
2004	3,895	11,724	33.8	76.8	715,615	1,360	11.4	50,709	43,950(r)
2003	3,879	11,429	33.3	76.8	776,095	1,352	12.1	47,479	42,795
2002	3,859	10,921	32.9	75.2	753,317	1,309	12.1	45,071	41,901
2001	3,840	10,732	32.6	74.0	816,057	1,278	10.5	44,047	42,044
2000	3,816	10,204	32.2	74.0	745,513	1,292	11.0	41,419	41,419
1999	3,800	9,659	31.8	75.0	749,192	1,306	12.5	38,281	40,225
1998	3,781	9,108	31.4	73.0	726,898	1,318	13.7	35,111	38,658

Source: Puerto Rico Planning Board, Department of Education, Department of Labor and Human Resources, and General Council of Education of the Commonwealth of Puerto Rico. The enrollment in private schools is an estimate.

* Population as of July 1 (in thousands).
** Amounts expressed in millions.
(p) Preliminary figures.
(r) Revised figures.

COMMONWEALTH OF PUERTO RICO

Average Employment by Sector (Unaudited)

Last Ten Fiscal Years

(In thousands)

Sector	2007 (p)	2006 (r)	2005 (r)	2004 (r)	2003 (r)	2002 (r)	2001 (r)	2000 (r)	1999 (r)	1998 (r)
Agriculture	16	22	26	25	24	23	21	24	27	31
Manufacturing	135	136	138	136	134	137	157	158	159	161
Mining	a/	a/	1	a/	a/	a/	a/	a/	a/	
Construction	94	88	87	88	82	84	84	84	78	69
Trade	260	271	261	253	252	236	239	237	228	236
Finance, insurance, and real estate	45	46	43	41	42	42	39	42	42	40
Transportation, communications, and public utilities	53	58	59	55(r)	57	62	56	55	59	59
Services	364	355	349	340	328	311	298	304	306	297
Government (1)	296	280	274	268	269	257	248	247	245	245
Total (2)	1,263	1,256	1,238	1,151	1,188	1,152	1,142	1,151	1,144	1,138

(p) Preliminary figures.
a/ Less than 2,000.
(r) Figures revised in accordance with the Census of Population and Housing of 2000.

(1) Includes the Commonwealth, its municipalities, and federal government, and excludes public corporations.
Sources: Puerto Rico Department of Labor and Human Resources, Household Survey, and Puerto Rico Planning Board.
(2) Totals may not add due to rounding.

COMMONWEALTH OF PUERTO RICO

Tourism Indicators (Unaudited)

Last Ten Fiscal Years

		2007 (p)	2006 (r)	2005	2004	2003	2002	2001	2000	1999	1998
All hotels and hostelry registration		2,049,839	2,160,455(r)	2,097,606	2,008,730	1,964,963	1,821,274	1,836,377	1,674,092	1,637,620	1,570,683
Occupancy rates		68.4%	67.9%	67.7%	68.9%	64.9%	67.8%	66.7%	70.7%	71.9%	67.3%
Number of rooms		13,600	13,577	13,459	12,864	12,788	12,768	12,353	11,928	11,102	11,848
Visitors' expenditures*	$	3,414	3,369	3,239	3,024	2,677	2,486	2,728	2,388	2,139	2,233

* Amounts expressed in millions of dollars.
(p) Preliminary figures.
(r) Revised figures.

Sources: Puerto Rico Tourism Company and Puerto Rico Planning Board.

(Continued)

COMMONWEALTH OF PUERTO RICO

Operating Indicators by Function (Unaudited)

Last Ten Fiscal Years

Function	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Fire protection:										
Number of stations	94	94	94	98	93	93	92	96	92	91
Fire personnel and officers	2,232	2,233	2,233	1,851	1,894	1,867	1,852	1,818	2,004	2,004
Calls answered	10,441	10,435	11,514	10,716	12,340	13,256	14,271	31,681	28,575	23,299
Building inspections conducted	73,478	73,360	71,610	56,093	53,750	41,415	31.693	44.396	14.621	30.139
Police protection:										
Number of stations	238	238	234	231	228	235	239	238	236	234
Police personnel and officers	19,069	20,552	20,806	21,185	21,079	20,468	20,800	20,822	20,305	19,934
Calls answered	7,101	7,146	7,178	6,907	5,538	4,673	4,957	5,059	4,545	4,748
Water system:										
Customers	1,290,497	1,285,732	1,251,699	1,256,981	1,238,461	1,209,834	1,195,038	1,179,109	1,163,673	1,148,284
Water consumption (millions of cubic meters)	350	365	356	359	350	349	348	350	348	343
Electric distribution system:										
Customers	1,452,529	1,450,227	1,438,699	1,419,602	1,401,301	1,383,888	1,365,668	1,344,907	1,326,055	1,309,954
Electricity consumption (millions of kilowatt)	20,672	20,620	20,507	20,260	19,887	19,130	18,723	18,144	16,989	17,457
Electricity production (millions of kilowatt)	25,082	24,870	24,500	24,100	23,717	22,514	22,132	21,461	20,140	20,725
Education:										
Enrollment in public schools:										
Kindergarten to sixth grade	293,796	306,073	323,270	321,653	326,606	334,929	341,467	341,470	350,714	354,098
Seventh to ninth grade	133,171	135,166	137,717	142,305	146,896	146,837	145,858	145,908	144,157	143,382
Tenth to twelfth grade	117,400	122,251	118,491	116,829	118,519	117,072	119,162	118,498	114,684	111,798
Enrollment in private schools:										
Kindergarten to sixth grade	105,724	124,483(r)	128,645(r)	83,548(r)	117,622	98,719(r)	135,655(r)	90,577(r)	90,577(r)	75,169(r)
Seventh to ninth grade	35,437	44,140(r)	41,888(r)	27,612(r)	37,226	31,245(r)	41,273(r)	27,366(r)	27,366(r)	23,777(r)
Tenth to twelfth grade	31,227	42,268(r)	36,808(r)	23,668(r)	29,226	24,515(r)	32,642(r)	21,694(r)	21,694(r)	18,674(r)
Enrollment in universities and colleges:										
Public	66,990	68,813	71,044	74,056	74,801	73,974	73,846	73,846	72,010	70,765
Private	158,412	140,734	136,650	132,735	125,041	117,578	100,704	100,704	103,623	101,020

Source: Various agencies and component units of the Commonwealth of Puerto Rico. The enrollment in private schools is an estimate.

APPENDIX III

FORM OF OPINION OF BOND COUNSEL

[This page intentionally left blank]

SIDLEY AUSTIN LLP
SIDLEY

SIDLEY AUSTIN LLP
787 SEVENTH AVENUE
NEW YORK, NY 10019
(212) 839 5300
(212) 839 5599 FAX

BEIJING
BRUSSELS
CHICAGO
DALLAS
FRANKFURT
GENEVA
HONG KONG
LONDON
LOS ANGELES
NEW YORK
SAN FRANCISCO
SHANGHAI
SINGAPORE
SYDNEY
TOKYO
WASHINGTON, D.C.

FOUNDED 1866

September __, 2008

Hon. Ángel Ortíz García
Acting Secretary of the Treasury of Puerto Rico
San Juan, Puerto Rico

Dear Sir:

As Bond Counsel to the Commonwealth of Puerto Rico, we have examined Act No. 243 of the Legislature of Puerto Rico (the "Legislature"), approved August 9, 2008, as supplemented by Joint Resolution No. 905 of the Legislature, approved August 9, 2008, as amended (collectively, the "Act"), and certified copies of the legal proceedings, including a resolution adopted by the Acting Secretary of the Treasury of the Commonwealth of Puerto Rico and approved by the Governor of the Commonwealth of Puerto Rico (the "Resolution"), the Tax Certificate executed and delivered by the Commonwealth of Puerto Rico in connection with the issuance of the Bonds, as hereinafter defined (the "Tax Certificate"), the opinion, dated September __, 2008, of Squire, Sanders & Dempsey L.L.P., Bond Counsel with respect to the conversion by Puerto Rico Public Buildings Authority of its $150,000,000 Government Facilities Revenue Refunding Bonds, Series M-3, Guaranteed by the Commonwealth of Puerto Rico (the "Converted Series M-3 Bonds") and other proofs submitted relative to the issuance and sale of the following described bonds (the "Bonds"):

$250,000,000

COMMONWEALTH OF PUERTO RICO

PUBLIC IMPROVEMENT BONDS OF 2008, SERIES A

Dated: Date of Delivery.

Maturing on July 1 of the years and in such principal amounts, subject to redemption and bearing interest at the rates, all as set forth in the Resolution. The Bonds are issuable as registered Bonds without coupons in the manner and in accordance with the terms and conditions of the Resolution.

We have also examined one of the Bonds as executed and authenticated.

In addition, for purposes of rendering the opinion described in paragraph 4, we are relying upon the aforementioned opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel with respect to the Converted Series M-3 Bonds, that interest on the Converted Series M-3 Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code").

From such examination we are of the opinion that:

1. The Act is valid.

2. Said proceedings have been validly and legally taken.

3. The Act and said proceedings and proofs show lawful authority for the issuance and sale of the Bonds, and the Bonds constitute valid and binding general obligations of the Commonwealth of Puerto Rico for the payment of the principal of and the interest on which the good faith, credit and taxing power of the Commonwealth of Puerto Rico are pledged.

4. Under the provisions of the Acts of Congress now in force and under existing regulations, rulings and court decisions, (i) subject to continuing compliance with the covenants of the Commonwealth of Puerto Rico and Puerto Rico Public Buildings Authority referred to below and requirements of the Code, and the Resolution regarding the use, expenditure and investment of Bond proceeds and the timely payment of certain investment earnings to the Treasury of the United States, if required, interest on the Bonds is not includable in gross income for federal income tax purposes; and (ii) the Bonds and the interest thereon are exempt from state, Commonwealth of Puerto Rico and local income taxation. We express no opinion as to the effect of any change to any document pertaining to the Bonds or the Converted Series M-3 Bonds or of any action taken or not taken where such change is made or action is taken or not taken without our approval or in reliance upon the advice of counsel other than ourselves with respect to the exclusion from gross income of the interest on the Bonds for federal income tax purposes.

Interest on the Bonds is not a specific item of tax preference for the purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Bonds is, however, includable in the computation of the alternative minimum tax on corporations imposed by the Code. The Code contains other provisions that could result in tax consequences, upon which we express no opinion, as a result of (a) ownership of Bonds or (b) the inclusion in certain computations (including, without limitation, those related to the corporate alternative minimum tax) of interest that is excluded from gross income.

The Commonwealth of Puerto Rico has covenanted to comply, to the extent permitted by the Constitution and laws of the Commonwealth of Puerto Rico, with the requirements of the Code so that interest on the Bonds will remain exempt from federal income taxes to which it is not subject on the date of issuance of the Bonds. Puerto Rico Public Buildings Authority has covenanted to comply, to the extent permitted by the Constitution and laws of the Commonwealth of Puerto Rico, with the requirements of the Code so that interest on the Converted Series M-3 Bonds will remain exempt from federal income taxes to which it is not subject on the date of issuance of the Bonds. We are not aware of any provisions of the Constitution or laws of the Commonwealth of Puerto Rico which would prevent the Commonwealth of Puerto Rico or said Authority from complying with the requirements of the Code.

Respectfully submitted,

[To be signed "Sidley Austin LLP"]

[This page intentionally left blank]

COMMONWEALTH OF PUERTO RICO • PUBLIC IMPROVEMENT BONDS OF 2008, SERIES A (GENERAL OBLIGATION BONDS)

Printed on Recycled Paper
IMAGEMASTER 800.452.5152