ARTHUR ANDERSEN LLP

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF PUERTO RICO AND ITS INSTRUMENTALITIES

FINANCIAL STATEMENTS AS OF JUNE 30, 1993, 1992 AND 1991 TOGETHER WITH AUDITORS' REPORT

ARTHUR ANDERSEN LLP

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Trustees of
Employees' Retirement System of the
Government of Puerto Rico and its
Instrumentalities:

We have audited the accompanying statements of net assets available for benefits of Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the System) as of June 30, 1993, 1992 and 1991, and the related statements of changes in net assets available for benefits for each of the three years in the period then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As explained in Note 4 to the financial statements, the report of the System's actuary reflects that, as of June 30, 1993, 1992 and 1991, accumulated benefits exceed assets available for benefits by approximately $4,332,000,000, $3,943,000,000 and $3,579,000,000, respectively.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities as of June 30, 1993, 1992 and 1991, and the changes in its net assets for each of the three years in the period then ended in conformity with generally accepted accounting principles.

Arthur Andersen LLP

San Juan, Puerto Rico,
July 22, 1994.

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EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT

OF PUERTO RICO AND ITS INSTRUMENTALITIES

STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

FOR THE YEARS ENDED JUNE 30, 1993, 1992 AND 1991

(In thousands)

	1993	1992	1991
INCOME FROM CASH, INVESTMENTS AND LOANS:			
Interest and dividends	$ 47,295	$ 48,498	$ 47,091
Net appreciation of investments	41,986	40,829	13,805
Other	2,348	2,617	1,874
Total income from cash, investments and loans	91,629	91,944	62,770
CONTRIBUTIONS:			
Employers	176,699	168,894	155,946
Participants	139,881	138,593	129,945
Special	12,224	12,146	11,595
Total contributions	328,804	319,633	297,486
Total additions	420,433	411,577	360,256
BENEFITS AND EXPENSES:			
Annuities	303,453	280,754	259,722
Death benefits	5,440	4,801	5,092
Refunds-			
Employers	749	383	341
Participants	9,330	7,272	4,577
Administrative expenses	15,867	14,677	14,790
Total deductions	334,839	307,887	284,522
Net increase in net assets available for benefits	85,594	103,690	75,734
NET ASSETS AVAILABLE FOR BENEFITS:			
Beginning of year	857,475	753,785	678,051
End of year	$943,069	$857,475	$753,785

The accompanying notes are an integral part of these statements.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT

OF PUERTO RICO AND ITS INSTRUMENTALITIES

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1993, 1992 AND 1991

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the System) was created by Act No. 447 on May 15, 1951. The System started operations on January 1, 1952, at which date contributions by employers and participants commenced. The System is considered an integral part of the Commonwealth of Puerto Rico (the Commonwealth) financial reporting entity and is included in the Commonwealth's financial reports as a Trust Fund. The System, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The responsibility for the proper operation and administration of the System is vested in a Board of Trustees, composed of two participants and one pensioner, who are appointed by the Governor of the Commonwealth and four government agencies representatives.

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

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with the provisions of Statement of Financial Accounting Standards No. 35, "Accounting and Reporting by Defined Benefit Pension Plans", and with the standards for disclosure established under Statement of Governmental Accounting Standards No. 5, "Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers". Participants' and employers' contributions are recognized as revenues in the period in which the employee services are rendered.

Cash and Cash Equivalents

Cash and cash equivalents consist of "overnight deposits" guaranteed by the custodial bank.

Investments

Investments are carried at fair value, except for certain mortgage notes which have no market. The fair value of notes, bonds and stocks is based on quotations obtained from national securities exchanges.

Securities transactions are accounted for on the settlement date. Differences in the accounting of securities based on the trade date, as required by generally accepted accounting principles, is not material. Realized gains and losses on securities are determined by the average cost method and are included in the statement of changes in net assets available for benefits.

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

No investment in any organization represents 5% or more of the System's net assets available for benefits.

Loans to Participants

Mortgage, personal and cultural trips loans to participants are stated at their outstanding principal balance. The personal loans are presented net of an allowance for uncollectible loans of $4,000,000 in 1993, 1992 and 1991. Maximum amounts that may be granted for mortgage, personal and cultural trip loans to participants are $75,000, $1,500 and $5,000, respectively. Loans to participants are secured by mortgage deeds, participants' contributions and any unrestricted excess in the escrow funds.

Guarantee Insurance Reserve

Premiums collected and benefits claimed are recorded as an addition and as a deduction of the guarantee insurance reserve.

2. PLAN DESCRIPTION:

The System is a defined benefit plan sponsored by the Commonwealth of Puerto Rico. Substantially all full-time and part-time employees of the Commonwealth of Puerto Rico and its Instrumentalities are covered by the System under the terms of the Acts No. 447 of 1951 and No. 110 of 1958, as amended. All regular employees of the Commonwealth under age 55 at the date of employment become members of the System as a condition to their employment. The System is optional for members of the Cabinet of the Governor, Heads of Agencies, and other appointed employees. At June 30, 1993, 1992 and 1991, total membership consisted of the following:

	1993	1992	1991
Retirees and beneficiaries currently receiving benefits	55,295	52,513	53,555
Current participant employees	154,237	151,188	139,467

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

Retirement Annuity

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

Policemen and Firemen	Other Employees
• Age 50 with 25 years of credited service	• Age 55 with 25 years of credited service or age 58 with 10 years of credited service

Participants are eligible for monthly benefit payments determined by the application of stipulated benefit ratios to the participant's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by the System. The annuity for which a participant is eligible is limited to a minimum of 30% and a maximum of 75% of the average compensation.

Merit Annuity

Participants are eligible for a merit annuity with a minimum of 30 years or more of credited service. The annuity for which the participant is eligible is limited to a maximum of 75% of the average compensation.

Deferred Retirement Annuity

A participant who ceases to be an employee of the Commonwealth after having accumulated a minimum of ten years of credited service qualifies for a retirement benefit provided the participant's contributions to the System are left within the System until attainment of the applicable normal retirement age.

Reversionary Annuity

A participant, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The payments would start after the death of the retiree in an amount not less than $240 yearly nor greater than the annuity payments being received by the retiree.

Occupational Disability Annuity

A participant who as a direct result of the performance of his/her occupation is totally and permanently disabled is eligible for an annuity of 50% of the salary in effect at the time of separation from employment.

Nonoccupational Disability Annuity

A participant totally and permanently disabled for causes not related to his/her occupation, and with no less than 10 years of credited service, is eligible for an annuity of 30% of the average compensation of the first 10 years of credited services increased by 1% for every additional year of credited service in excess of 10 years up to a maximum of 50% of the average compensation.

Death Benefits

The beneficiaries of a participant who dies as a direct result of the performance of his/her occupation are eligible for the following benefits:

- Widow - annuity equal to 50% of the participant's salary at the date of the death.

- Children - $10 per month for each child, minor or student, up to a maximum benefit per family of 100% of the participant's salary at the date of the death. If no widow 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.

In addition, upon the death of a participant, the beneficiary(ies) is(are) eligible to receive the following:

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

- Retiree - 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.

Refunds

A participant who ceases his/her employment with the Commonwealth has the right to a refund of the contributions to the System plus any interest earned.

Amendment to Benefits Payable to Participants Who
Joined the System on or after April 1, 1990

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

Act No. 10 of 1992 provides, retroactive to January 1, 1992, for periodic increases of 3% of the pensions paid by the System to those participants with three or more years of retirement.

Termination

Although the Commonwealth has not expressed any intent to terminate the plan, it may do so at any time. In the event of termination of the plan, the rights of all affected participants and beneficiaries to whom benefits have been accrued under the plan shall be nonforfeitable to the extent funded.

3. FUNDING POLICY:

The contribution requirement to the System is established by law and is not actuarially determined. Required contributions consist of 9.275% of applicable payroll in the cases of municipalities, central government and public corporations, and 5.775% or 8.275% for members' contributions. The current level of contributions from the Commonwealth and the members, together with the income of the System's investments and others, should theoretically be sufficient to cover the payments of annuities and benefits to be provided by the System in the near term.

The special contributions of approximately $12,224,000, $12,146,000 and $11,595,000 in 1993, 1992 and 1991, respectively, represent the reimbursement to the System of the benefits paid on behalf of the General Fund of the Commonwealth under the provision of Law No. 127 of 1958 which covers the occupational disability of firemen, policemen and others and under the provisions of Law No. 23 of 1983 which covers half of the increase in pension benefit annuities.

Calculations of the present value of benefits under the System were made by consulting actuaries as of June 30, 1993, 1992 and 1991, using the projected unit credit actuarial cost method. Significant assumptions underlying the actuarial computations include: (a) assumed rate of return on investments of 8.5% for 1993 and 9% for 1992 and 1991; (b) assumed compounded rate of wage increases of 5% per year for 1993 and 6% per year for 1992 and 1991; (c) assumed mortality rate based on the Group Annuity Table for 1951 for the three years. The effect of changed assumptions on the 1993 total benefit obligation was to decrease total obligation by $96,500,000.

4. FUNDING STATUS AND HISTORICAL TREND INFORMATION:

The amount shown below as the pension benefit obligation is a standardized disclosure measure of the present value of pension benefits, adjusted for the effect of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure is intended to help users assess the funding status of the System on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among employers. The measure is the actuarial present value of credited projected benefits, and is independent of the funding method used to determine contributions to the System (Note 3).

The actuarial present value of accumulated plan benefits is summarized as follows:

	1993	1992 (In thousands)	1991
Retirees, beneficiaries, and terminated employees	$2,631,000	$2,300,000	$2,144,000
Current employees:			
Accumulated employee contributions	1,125,000	900,000	784,000
Employer-financed vested benefits	1,421,000	1,500,000	1,283,000
Employer-financed nonvested benefits	98,000	100,000	122,000
	2,644,000	2,500,000	2,189,000
Total pension benefit obligation	5,275,000	4,800,000	4,333,000
Net assets available for benefit	943,069	857,475	753,785
Accumulated benefits in excess of net assets available	$4,331,931	$3,942,525	$3,579,215

The Legislature of the Commonwealth enacted Act No. 1, effective April 1, 1990, which is directed to improve the solvency of the System for the next 50 years. Among other provisions, the legislation increases the level of contribution to the System and limits benefits for new employees by increasing the age from 55 to 65 years for the vesting of certain benefits and reducing the level of benefits in the case of early retirement. The legislation also reduces the level of occupational injury and death benefits received by new employees from 50% to 40% (see Notes 2 and 3).

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due. Available trend information is as follows:

	1993	1992	1991	1990 (In thousands)	1989	1988
Net assets available for benefits	$ 943,069	$ 857,475	$ 753,785	$ 678,051	$ 628,161	$ 596,870
Total pension benefit obligation	$5,275,000	$4,800,000	$4,333,000	$4,300,000	$4,009,000	$3,570,000
Net assets available for benefits as a percentage of total pension benefit obligation	18%	18%	17%	16%	16%	17%
Unfunded pension benefit obligation	$4,331,931	$3,942,525	$3,579,215	$3,621,949	$3,380,839	$2,973,130
Annual covered payroll	$1,485,000	$1,359,000	$1,609,000	$1,495,990	$1,407,595	$1,285,971
Unfunded pension benefit obligation as a percentage of covered payroll	292%	290%	222%	242%	240%	231%
Employer contributions as a percentage of covered payroll	12%	12%	10%	8%	8%	8%

Analysis of the dollar amounts of net assets available for benefits, total pension benefit obligation, and unfunded pension benefit obligation in isolation can be misleading. Expressing the net assets available for benefits as a percentage of total pension benefit obligation provides one indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the

System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the plan. Trends in the unfunded pension benefit obligation and annual covered payroll are both affected by inflation. Expressing the unfunded pension benefit obligation as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the System's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the plan.

Trend information prior to 1988 is not available.

The information presented on the following table from 1984 through 1987, inclusive, is unaudited. From 1988 to 1990, it was audited by a firm other than Arthur Andersen LLP.

	Revenues by Source			
Fiscal Year	Participants Contributions	Employers Contributions (In thousands)	Investment and Dividends	Total
1984	$ 56,996	$ 75,287	$46,908	$179,191
1985	62,506	86,112	45,706	194,324
1986	65,209	87,661	45,681	198,551
1987	72,371	98,562	48,362	219,295
1988	79,525	102,878	48,425	230,828
1989	88,042	112,608	48,459	249,109
1990	99,649	124,167	50,626	274,442
1991	129,945	155,946	47,091	332,982
1992	138,593	168,894	48,498	355,985
1993	139,881	176,699	47,295	363,875

	Expenses by Type			
Fiscal Year	Benefits	Administrative Expenses (In thousands)	Refunds	Total
1984	$159,721	$ 7,499	$ 5,137	$172,357
1985	167,084	8,801	5,250	181,135
1986	177,845	8,132	5,830	191,807
1987	189,945	8,415	5,764	204,124
1988	203,600	10,945	5,630	220,175
1989	232,942	12,269	6,060	251,271
1990	246,424	12,529	7,334	266,287
1991	264,814	14,790	4,918	284,522
1992	285,555	14,677	7,655	307,887
1993	308,893	15,867	10,079	334,839

5. CASH AND INVESTMENTS:

Pursuant to the provisions of Act No. 46 of 1988, the System may invest, with certain restrictions, in obligations of the Commonwealth and its Instrumentalities, the United States of America, private corporations and foreign countries. The System may also invest in common and preferred stock issued by any corporation incorporated under the laws of the Commonwealth and the United States of America. In addition, the System may invest in income-producing real properties and in high-risk securities.

Cash and cash equivalents are guaranteed by the custodial bank. Cash deposited with Government Development Bank for Puerto Rico amounting to $96,969,000, $64,757,000 and $21,795,000 as of June 30, 1993, 1992 and 1991, respectively, is not collateralized.

The following table shows the market value and amortized cost of the investments in marketable securities held by the System as of June 30, 1993, 1992 and 1991. The following investments are held by agents in the System's name:

	1993		1992		1991	
	Cost or Amortized Cost	Fair Value	Cost or Amortized Cost	Fair Value	Cost or Amortized Cost	Fair Value
			(In thousands)			
U.S. Government and agencies' securities	$ 97,806	$104,455	$107,522	$112,779	$ 99,161	$100,128
Corporate bonds	35,334	36,877	29,710	30,727	41,383	41,909
Corporate stocks	266,236	337,945	234,930	292,028	191,084	235,980
Total marketable securities	$399,376	$479,277	$372,162	$435,534	$331,628	$378,017

The net changes in the appreciation of investments in marketable securities are as follows:

	1993	1992	1991
		(In thousands)	
Securities held at year-end:			
Notes and bonds	$ 1,919	$ 4,781	$ 1,591
Stocks	14,583	12,203	3,237
	16,502	16,984	4,828
Securities sold during the year	25,484	23,845	8,977
	$41,986	$40,829	$13,805

6. PROPERTY AND EQUIPMENT:

Property and equipment acquisitions are recorded at cost. Depreciation is provided using the straight-line method over the useful life of the asset. At June 30, 1993, 1992 and 1991, property and equipment consist of the following:

	Estimated Useful Life	1993	1992 (In thousands)	1991
Land	-	$ 969	$ 969	$ 969
Building	50 years	7,631	7,631	7,631
Furniture and equipment	5 - 10 years	3,798	3,364	3,644
		12,398	11,964	12,244
Accumulated depreciation		(4,759)	(4,398)	(4,312)
		$ 7,639	$ 7,566	$ 7,932

7. OTHER ASSETS:

At June 30, 1993, 1992 and 1991, other assets consist of the following:

	1993	1992 (In thousands)	1991
Repossessed and in-substance foreclosed properties	$ 3,346	$ 3,371	$ 3,470
Executed land	13,532	13,532	13,532
	$16,878	$16,903	$17,002

Repossessed and in-substance foreclosed properties consist mainly of properties acquired or to be acquired upon foreclosure proceedings as collateral from delinquent mortgage loans. Foreclosed properties are valued at the outstanding principal balance of the related mortgage upon foreclosure. These will be sold under a biding process intended to recover the outstanding principal balance. Gain or loss is recognized at the time of sale. Differences resulting from recognition of losses at the point of sale rather than upon foreclosure, as required by generally accepted accounting principles, is not material.

The executed land located in Hato Rey was acquired on February 19, 1991, from the Metropolitan Bus Authority (MBA) as settlement for the debt MBA had with the System relative to employer and participants contributions and loans retention from June 1985 through December 1988. The System has been renting this land to a third party which operates it as a parking facility. Rental income for 1993, 1992 and 1991 amounted to $96,000, $96,000 and $32,000, respectively, and is reflected as part of other investment income from the accompanying statement of changes in assets available for benefits.

8. GUARANTEE INSURANCE RESERVE OVER LOANS TO PARTICIPANTS:

The System provides life insurance which guarantees the payment of the outstanding principal balance of mortgage, personal and cultural trips loans in case of death of a participant. This coverage is paid in its entirety by the participants who obtain these loans from the System. The life insurance rates are actuarially determined and do not vary by age, sex or health status.

9. COMMITMENTS AND CONTINGENT LIABILITIES:

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

10. SUBSEQUENT EVENTS:

On March 24, 1994, the System swapped approximately $67,000,000 of its mortgage loan portfolio in exchange for Federal National Mortgage Association (FNMA) Guaranteed Mortgage Pass-Through Securities. This transaction was completed through two contracts amounting to $33,000,000 and $34,000,000, respectively. The System will continue servicing the swapped mortgages for a fee of 0.25%. An annual guarantee fee of 0.16% of the outstanding mortgage is payable monthly to FNMA. This fee may be adjusted by certain conditions as specified in the contract. For the $34,000,000 contract, the System agreed to bear the risk of loss from borrowers' defaults (including principal, interest and cost associated with foreclosure). If a mortgage loan becomes 120 days delinquent, the System shall repurchase such mortgage loan (Lender Loss Obligation). Management believes any possible loss will not be material for financial statement purposes.

To secure the System's performance under the Lender Loss Obligation, the System delivered to Bank America National Trust Company, as custodian, collateral in the form of U.S. Treasury Securities equivalent to 4.5% of the aggregate issue date principal balance of all mortgage loans. This collateral will be returned once certain conditions are met by the System.

EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT

OF PUERTO RICO AND ITS INSTRUMENTALITIES

STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS

JUNE 30, 1993, 1992 AND 1991

(In thousands)

	1993	1992	1991
CASH AND INVESTMENTS:			
Cash and cash equivalents	$ 34,977	$ 18,900	$ 17,106
Cash deposited with Government Development Bank for Puerto Rico	96,969	64,757	21,795
Total cash	131,946	83,657	38,901
Marketable securities-			
Notes and bonds	141,332	143,506	142,037
Stocks	337,945	292,028	235,980
Total marketable securities	479,277	435,534	378,017
Mortgages notes acquired from third parties	11,607	14,330	16,684
Total cash and investments	622,830	533,521	433,602
LOANS TO PARTICIPANTS:			
Mortgage	206,122	210,371	213,795
Personal	77,438	73,825	67,583
Cultural trips	6,971	6,428	6,196
Total loans to participants	290,531	290,624	287,574
Total cash, investments and loans to participants	913,361	824,145	721,176
ACCOUNTS RECEIVABLE:			
Employers	15,290	18,533	17,790
General Fund of the Government of Puerto Rico	6,977	5,457	8,001
Commonwealth of Puerto Rico Judiciary Retirement System	573	504	414
Interest on investments	4,014	3,631	4,026
Other	4,035	6,119	3,796
Total accounts receivable	30,889	34,244	34,027
PROPERTY AND EQUIPMENT, net	7,639	7,566	7,932
OTHER ASSETS	16,878	16,903	17,002
Total assets	968,767	882,858	780,137
ESCROW FUNDS OF MORTGAGE LOANS AND GUARANTEE INSURANCE RESERVE OF LOANS TO PARTICIPANTS	20,013	19,915	20,962
BENEFITS PAYABLE	2,200	2,200	2,200
OTHER LIABILITIES	3,485	3,268	3,190
Total liabilities	25,698	25,383	26,352
Net assets available for benefits	$943,069	$857,475	$753,785

The accompanying notes are an integral part of these statements.