ARTHUR ANDERSEN LLP

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

FINANCIAL STATEMENTS
AS OF JUNE 30, 1994 AND 1993
TOGETHER WITH AUDITORS' REPORT

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, 1994 and 1993, and the related statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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.

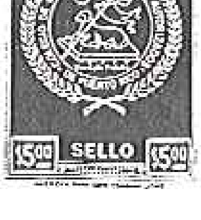
As explained in Note 4 to the financial statements, the report of the System's actuary reflects that, as of June 30, 1994 and 1993, accumulated benefits exceed assets available for benefits by approximately $4,588,000,000 and $4,332,000,000, respectively.

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, 1994 and 1993, and the changes in its net assets for the years then ended in conformity with generally accepted accounting principles.

Arthur Andersen LLP

San Juan, Puerto Rico,
December 30, 1994.

1256461



EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT

OF PUERTO RICO AND ITS INSTRUMENTALITIES

STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS

JUNE 30, 1994 AND 1993

(In thousands)

	1994	1993
CASH AND INVESTMENTS:		
Cash and cash equivalents	$ 27,850	$ 34,977
Cash deposited with Government Development Bank for Puerto Rico	75,165	96,969
Total cash	103,015	131,946
Marketable securities-		
Notes and bonds	156,126	141,332
Stocks	333,295	337,945
Mortgage-backed securities	65,434	-
Total marketable securities	554,855	479,277
Mortgages notes acquired from third parties	8,522	11,607
Total cash and investments	666,392	622,830
LOANS TO PARTICIPANTS:		
Mortgage	127,777	206,122
Personal	124,743	77,438
Cultural trips	7,002	6,971
Total loans to participants	259,522	290,531
Total cash, investments and loans to participants	925,914	913,361
ACCOUNTS RECEIVABLE:		
Employers	16,101	15,290
General Fund of the Government of Puerto Rico	5,709	6,977
Commonwealth of Puerto Rico Judiciary Retirement System	761	573
Interest on investments	3,658	4,014
Other	4,412	4,035
Total accounts receivable	30,641	30,889
PROPERTY AND EQUIPMENT, net	7,484	7,639
OTHER ASSETS	16,721	16,878
Total assets	980,760	968,767
ESCROW FUNDS OF MORTGAGE LOANS AND GUARANTEE INSURANCE RESERVE OF LOANS TO PARTICIPANTS	16,164	20,013
BENEFITS PAYABLE	6,100	2,200
OTHER LIABILITIES	4,870	3,485
Total liabilities	27,134	25,698
Net assets available for benefits	$953,626	$943,069

The accompanying notes are an integral part of these statements.

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, 1994 AND 1993

(In thousands)

	1994	1993
INCOME FROM CASH, INVESTMENTS AND LOANS:		
Interest and dividends	$ 36,715	$ 47,295
Net (depreciation) appreciation of investments	(14,695)	41,986
Other	2,513	2,348
Total income from cash, investments and loans	24,533	91,629
CONTRIBUTIONS:		
Employers	190,946	176,699
Participants	150,121	139,881
Special	12,801	12,224
Total contributions	353,868	328,804
Total additions	378,401	420,433
BENEFITS AND EXPENSES:		
Annuities	332,608	303,453
Death benefits	5,366	5,440
Refunds-		
Employers	772	749
Participants	11,513	9,330
Administrative expenses	17,585	15,867
Total deductions	367,844	334,839
Net increase in net assets available for benefits	10,557	85,594
NET ASSETS AVAILABLE FOR BENEFITS:		
Beginning of year	943,069	857,475
End of year	$953,626	$943,069

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, 1994 AND 1993

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 statements 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. Mortgage-backed securities consist of Federal National Mortgage Association (FNMA) Guaranteed Mortgage Pass-Through securities acquired during March 1994. Fair value of these securities approximates cost at June 30, 1994, (refer to Note 5).

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. No allowance for uncollectible amounts has been established since loans to participants are secured by mortgage deeds, participants' contributions and any unrestricted amount remaining in the escrow funds. Maximum amounts that may be granted to participants for mortgage, personal and cultural trip loans are $100,000, $3,000 and $5,000 for 1994, respectively, and $75,000, $1,500 and $5,000 for 1993, respectively.

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. Substantially all full-time employees of the Commonwealth and its Instrumentalities are covered by the System under the terms of the Act No. 447 of 1951. 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, 1994 and 1993, total membership consisted of the following:

	1994	1993
Retirees and beneficiaries currently receiving benefits	57,566	55,295
Current participant employees	151,935	154,237

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 $200 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 58 years of 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

Occupational-

- 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.

Nonoccupational-

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

Post-retirement-

- Beneficiary - with widow and child, 18 or under, up to 60% of retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of $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.

Amendment to Benefits Payable to Participants
Effective January 1, 1992

Act No. 10 of 1992 provides, retroactive to January 1, 1992, for increases of 3%, every three years, of the pensions paid by the System to those participants with three or more years of retirement subject to approval by the Legislature and external funding.

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 \$12,801,000 and \$12,224,000 in 1994 and 1993, 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, 1994 and 1993, using the projected unit credit actuarial cost method. Significant assumptions underlying the actuarial computations include: (a) assumed rate of return on investments of 8.5%; (b) assumed compound rate of wage increases of 5% per year; (c) assumed mortality rate based on the Group Annuity Table for 1951.

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:

	1994	1993
	(In thousands)	
Retirees, beneficiaries, and terminated employees	$2,888,000	$2,631,000
Current employees-		
Accumulated employee contributions	1,128,000	1,125,000
Employer-financed vested benefits	1,428,000	1,421,000
Employer-financed nonvested benefits	98,000	98,000
	2,654,000	2,644,000
Total pension benefit obligation	5,542,000	5,275,000
Net assets available for benefits	953,626	943,069
Accumulated benefits in excess of net assets available	$4,588,374	$4,331,931

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:

	1994	1993	1992	1991	1990	1989	1988
			(In thousands)				
Net assets available for benefits	$ 953,626	$ 943,069	$ 857,475	$ 753,785	$ 678,051	$ 628,161	$ 596,870
Total pension benefit obligation	$5,542,000	$5,275,000	$4,800,000	$4,333,000	$4,300,000	$1,009,000	$3,570,000
Net assets available for benefits as a percentage of total pension benefit obligation	17%	18%	18%	17%	16%	16%	17%
Unfunded pension benefit obligation	$4,588,374	$4,331,931	$3,942,525	$3,579,215	$3,621,949	$3,380,839	$2,973,130
Annual covered payroll	$1,867,000	$1,882,000	$1,672,000	$1,609,000	$1,495,990	$1,407,595	$1,285,971
Unfunded pension benefit obligation as a percentage of covered payroll	245%	230%	236%	222%	242%	240%	231%
Employer contributions as a percentage of covered payroll	10%	10%	10%	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 1985 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
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
1994	150,121	190,946	36,715	377,782

	Expenses by Type			
Fiscal Year	Benefits	Administrative Expenses (In thousands)	Refunds	Total
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
1994	337,974	17,585	12,285	367,844

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 (GDB) amounting to $75,165,000 and $96,969,000 as of June 30, 1994 and 1993, respectively, is not collateralized.

The following table shows the carrying amount and market value of the investments in marketable securities held by the System as of June 30, 1994 and 1993. The following investments are held by agents in the System's name:

	1994		1993	
	Cost or Amortized Cost	Fair Value	Cost or Amortized Cost	Fair Value
		(In thousands)		
U.S. Government and agencies' securities	$119,606	$115,181	$ 97,806	$104,455
Corporate bonds	41,874	40,945	35,334	36,877
Corporate stocks	294,930	333,295	266,236	337,945
Mortgage-backed securities	65,434	65,434	-	-
Total marketable securities	$521,844	$554,855	$399,376	$479,277

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

	1994	1993
	(In thousands)	
Securities held at year-end-		
Notes and bonds	$(13,477)	$ 1,919
Stocks	(33,316)	14,583
	(46,793)	16,502
Securities sold during the year	32,098	25,484
	$(14,695)	$41,986

On March 24, 1994, the System swapped approximately $67,000,000 of its mortgage loan portfolio in exchange for FNMA Guaranteed Mortgage Pass-Through Securities. This transaction was completed through two contracts amounting to $33,000,000 and $34,000,000, respectively. The acquired securities have been classified as mortgage-backed securities in the accompanying statement of net assets available for benefits. 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 that the effect of any related loss will not be material for financial statements 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.

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, 1994 and 1993, property and equipment consist of the following:

	Estimated Useful Life	1994	1993
		(In thousands)	
Land	-	$ 969	$ 969
Building	50 years	7,631	7,631
Furniture and equipment	5 - 10 years	4,083	3,798
		12,683	12,398
Accumulated depreciation		(5,199)	(4,759)
		$ 7,484	$ 7,639

7. OTHER ASSETS:

At June 30, 1994 and 1993, other assets consist of the following:

	1994	1993
	(In thousands)	
Repossessed and in-substance foreclosed properties	$ 3,189	$ 3,346
Executed land	13,532	13,532
	$16,721	$16,878

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 bidding process intended to recover the outstanding principal balance. Gain or loss is recognized at the time of sale. Differences resulting from recognition of losses at the point of sale rather than upon foreclosure, as required by 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), a government agency, as settlement for the debt MBA had with the System relative to employer and participants contributions and loans payments withholdings 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 1994 and 1993 amounted to $96,000 each year, and is reflected as part of other investment income in the accompanying statements 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, if any, will not have a significant effect on the financial status of the System.

10. SUBSEQUENT EVENTS:

On July 20, 1994, the System's Board of Trustees authorized the issuance of Collateralized Promissory Notes (the Notes) to generate additional funds to carry out the investment objectives and to improve the investment portfolio. The Notes can not exceed, in an aggregate principal amount, $200,000,000 outstanding at any time, and a term to maturity up to 90 days so that at the end of each quarter the outstanding balance equals zero. The Notes will be secured by a pledge on the System's securities. GDB will act as the System's agent for selling the Notes, effecting the pledge on the securities, securing them, investing their proceeds and acting as custodian of the securities purchased with the proceeds. GDB will issue and sell the Notes through brokers and record the transfer of and make payments of principal and interest on the Notes, all under such terms and conditions, and at such interest rates and prices, as the GDB shall consider to be in the best interest of the System. In connection with such issuance, GDB will pay a commission from the proceeds of the Notes to these brokers, in an amount to be determined.

On December 14, 1994, the Board of Trustees changed the maximum principal amount from $200,000,000 to $400,000,000.

In addition, on December 14, 1994, the Board of Trustees approved the sale of the portfolio of the FNMA Guaranteed Mortgage Pass-Through securities acquired during March 1994. The net proceeds will be invested in short-term and liquid securities. GDB will also act as sales agent and will manage the investment portfolio.