

ARTHUR ANDERSEN LLP

**THE COMMONWEALTH OF PUERTO RICO
JUDICIARY RETIREMENT SYSTEM**

*FINANCIAL STATEMENTS
AS OF JUNE 30, 1998 AND 1997
TOGETHER WITH AUDITORS' REPORT*

ARTHUR ANDERSEN LLP

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Trustees of
The Commonwealth of Puerto Rico
Judiciary Retirement System:

We have audited the accompanying statements of plan net assets of The Commonwealth of Puerto Rico Judiciary Retirement System (the System) as of June 30, 1998 and 1997, and the related statements of changes in plan net assets for the years then ended. These financial statements and the schedules referred to below are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements and schedules 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of The Commonwealth of Puerto Rico Judiciary Retirement System as of June 30, 1998 and 1997, and the changes in its plan net assets for the years then ended in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information shown in the accompanying schedules of Funding Progress and Contributions and related notes are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



San Juan, Puerto Rico,
September 28, 1998.

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THE COMMONWEALTH OF PUERTO RICO

JUDICIARY RETIREMENT SYSTEM

STATEMENTS OF PLAN NET ASSETS

JUNE 30, 1998 AND 1997

(In thousands)

	<u>1998</u>	<u>1997</u>
<u>ASSETS</u>		
CASH AND INVESTMENTS:		
Cash and cash equivalents	5,828	\$ 1,176
Cash deposited with Government Development Bank for Puerto Rico-		
Unrestricted	2,816	922
Restricted	4	19
Total cash	<u>3,648</u>	<u>2,117</u>
Marketable securities-		
Notes and bonds	18,321	10,187
Stocks	47,478	45,345
Total marketable securities	<u>65,799</u>	<u>55,532</u>
Mortgage notes acquired from third parties	205	253
Total cash and investments	<u>69,652</u>	<u>57,902</u>
LOANS TO PLAN MEMBERS:		
Mortgage	68	317
Personal	131	122
Cultural trips	52	54
Total loans to plan members	<u>251</u>	<u>493</u>
Total cash, investments and loans to plan members	<u>69,903</u>	<u>58,395</u>
RECEIVABLES:		
Accrued interest	491	224
Other	49	102
Total assets	<u>70,443</u>	<u>58,721</u>
 <u>LIABILITIES</u>		
DUE TO THE EMPLOYEES' RETIREMENT SYSTEM OF THE GOVERNMENT OF PUERTO RICO	3,120	1,268
ESCROW FUNDS TO PLAN MEMBERS AND GUARANTEE INSURANCE RESERVE FOR LOANS TO PLAN MEMBERS	142	154
OTHER LIABILITIES	2	44
Total liabilities	<u>3,264</u>	<u>1,466</u>
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (see accompanying Schedule of Funding Progress)	<u>\$67,179</u>	<u>\$57,255</u>

The accompanying notes are an integral part of these statements.

THE COMMONWEALTH OF PUERTO RICO

JUDICIARY RETIREMENT SYSTEM

STATEMENTS OF CHANGES IN PLAN NET ASSETS

FOR THE YEARS ENDED JUNE 30, 1998 AND 1997

(In thousands)

	<u>1998</u>	<u>1997</u>
ADDITIONS:		
Contributions-		
Employer	\$ 4,239	\$ 4,102
Participating employees	1,873	1,763
Total contributions	<u>6,112</u>	<u>5,865</u>
Investment income -		
Net appreciation in investment reported at fair value	10,290	7,648
Interest and dividend income	1,757	1,642
	<u>12,047</u>	<u>9,290</u>
Less investment expense	742	517
Net investment income	<u>11,305</u>	<u>8,773</u>
Total additions	<u>17,417</u>	<u>14,638</u>
DEDUCTIONS:		
Annuities	6,550	6,080
Administrative expenses	943	1,298
Total deductions	<u>7,493</u>	<u>7,378</u>
Net increase	<u>9,924</u>	<u>7,260</u>
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS:		
Beginning of year	57,255	49,995
End of year	<u>\$67,179</u>	<u>\$57,255</u>

The accompanying notes are an integral part of these statements.

THE COMMONWEALTH OF PUERTO RICO

JUDICIARY RETIREMENT SYSTEM

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1998 AND 1997

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Commonwealth of Puerto Rico Judiciary Retirement System (the System) was created by Act No. 12 on October 19, 1954. 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 operation and administration of the System is vested in a Board of Trustees, composed of two participating employees and one pensioner, who are appointed by the Governor of the Commonwealth and four Commonwealth government agency representatives.

The System is not an employer. The System's operations are managed by the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS allocations of administration costs to the System amounted to \$875,066 and \$1,053,000 for the years ended June 30, 1998 and 1997, respectively.

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 Governmental Accounting Standards No. 25 (SGAS No. 25), "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans". Participating employees' and employer's contributions are recognized as revenues in the period in which the employee services are rendered. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents consist of "overnight deposits" guaranteed by the custodial bank. Restricted cash deposited with Government Development Bank for Puerto Rico (GDB) consists of payments received from mortgage loanholders to be used by Banco Popular de Puerto Rico in the servicing of loan escrows.

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 trade date. Realized gains and losses on securities are determined by the average cost method and are included in the statement of changes in plan net assets.

Mortgages 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 held in trust for pension benefits.

Loans to Plan Members

Mortgage, personal and cultural trip loans to plan members are stated at their outstanding principal balance. No allowance for uncollectible amounts has been established since loans to plan members are secured by mortgage deeds, judges' contributions and any unrestricted amount remaining in the escrow funds. Maximum amounts that may be granted for mortgage, personal and cultural trip loans to plan members are \$100,000, \$3,000 and \$5,000, respectively. The carrying value of these loans approximates their fair value.

During fiscal 1998, the System sold mortgage loans with a principal balance of approximately \$241,400 to FNMA at a gain of approximately \$8,800. The sale contract stipulates that the System must repurchase any loans with payments in arrears over 90 days. As of June 30, 1998, the System had not repurchased any loans.

Guarantee Insurance Reserve

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

2. PLAN DESCRIPTION:

The System is a single-employer defined benefit plan sponsored by the Commonwealth. Under the terms of the Act No. 12 of 1954, as amended, all judges of the Judiciary Branch of the Commonwealth are plan members of the System. At June 30, 1998 and 1997, membership consisted of the following:

	<u>1998</u>	<u>1997</u>
Retirees and beneficiaries currently receiving benefits	242	230
	===	===
Current participating employees	316	306
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The plan members of the System are eligible for the following benefits:

Retirement Annuity

Plan members with 10 years of credited service are eligible for retirement upon reaching 60 years of age.

Plan members are eligible for monthly benefit payments determined by the application of stipulated benefit ratios to the plan member's average compensation. Average compensation is computed based on the last three years of service (effective July 28, 1993, highest monthly salary), except for the judges of the

Supreme Court for whom it is based on the last month of compensation. The annuity for which a plan member is eligible is limited to a minimum of 25% and a maximum of 75% of the average compensation except for the 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.

Reversionary Annuity

A plan member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The payments would start after the death of the retiree, in an amount not less than \$120 yearly nor greater than the annuity payments being received by the retiree.

Occupational Disability Annuity

A participating employee permanently disabled is eligible for a disability annuity of 50% of the compensation received at the time of the disability.

Nonoccupational Disability Annuity

A participating employee totally and permanently disabled for causes not related to his/her occupation, and with no less than 10 years of credited service, is eligible for an annuity of 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-

- Surviving spouse - annuity equal to 50% of the participating employee's salary at the date of the death.
- Children - \$10 per month for each child, minor or student, up to a maximum benefit per family of 75% of the participating employee's salary at the date of the death. If no spouse survives or dies while receiving the annuity payments, each child, 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 ineligible for survivor benefit - 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.
- Surviving spouse and child, 21 or under - up to 60% of the pension that would have been payable had the participating employee retired on the date of death.

Post-retirement-

- Beneficiary - with surviving spouse and child, 21 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 participating employee who ceases his/her employment with the Commonwealth without right to a retirement annuity has the right to a refund of the contributions to the System plus any interest earned.

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 plan members and beneficiaries to whom benefits have 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 20% of applicable payroll for the employer and 8% for the participating employees. Commonwealth contributions should ultimately cover any deficiency between the participating employees' contributions and the System's pension benefit obligations and administrative costs.

Calculations of the present value of benefits under the System were made by consulting actuaries as of June 30, 1998 and 1997, 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%; and (c) assumed mortality rate based on the Group Annuity Table for 1951.

The actuarial accrued liability was \$95,600,000 and \$76,500,000 as of June 30, 1998 and 1997, respectively. At June 30, 1998 and 1997, the unfunded actuarial accrued liability was approximately \$28,400,000 and \$19,200,000, respectively.

4. 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. In addition, the System may invest in common and preferred stock, in income-producing real properties and in high-risk securities.

Cash and cash equivalents are guaranteed by the custodial bank. Cash deposited with GDB is not collateralized.

The following table shows the cost and market value of the investments in marketable securities held by the System as of June 30, 1998 and 1997. The following investments are held by agents in the System's name:

	1998		1997	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
	(In thousands)			
U.S. Government and agencies' securities	\$16,145	\$16,389	\$ 9,644	\$ 9,483
Corporate bonds	1,917	1,932	706	704
Domestic corporate stocks	28,861	41,061	33,841	45,345
International corporate stocks	3,499	6,417	-	-
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	\$52,422	\$65,799	\$44,191	\$55,532
	=====	=====	=====	=====

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

	1998	1997
	(In thousands)	
Securities held at year-end-		
Notes and bonds	\$ 422	\$ 80
Stocks	1,615	4,730
	-----	-----
	2,037	4,810
Securities sold during the year	8,253	2,838
	-----	-----
	\$10,290	\$7,648
	=====	=====

5. GUARANTEE INSURANCE RESERVE OVER LOANS TO PLAN MEMBERS:

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

6. YEAR 2000 CONVERSION (UNAUDITED):

ERS, as part of the administration of the System, manages all the critical information and operations systems. ERS has conducted a comprehensive review of its computer systems to identify the systems that could be affected by the Year 2000 Issue and is currently evaluating external consultants as part of the plan to resolve the issue. The Year 2000 Issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a major system failure or miscalculations. ERS management presently believes that, with modifications to existing software and converting to new software, the Year 2000 Issue will not pose significant operational problems for the computer systems as so modified and converted. However, if such modifications and conversions are not completed timely, the Year 2000 Issue may have a material impact on the operations of the System.

As of June 30, 1998, the ERS' Year 2000 Compliance Project (the Project) stages and their completion are as follows:

Awareness stage	100%
Assessment stage	10%
Remediation stage	40%
Validation/Testing stage	Not commenced
Implementation stage	Not commenced

Although ERS has completed the awareness stage of the Project as of June 30, 1998, it is management's opinion that information related to the Project will have to be revised due to the delays in its implementation.

As of June 30, 1998, ERS has incurred expenses amounting to approximately \$300,000 in equipment upgrades related specifically to the Project. An additional expense of approximately \$18,000 was incurred in equipment upgrades related to the Project, but which would have been replaced in the near future due to obsolescence. ERS has entered into contracts amounting to approximately \$25,000 related to services required to complete the Project.

7. RECLASSIFICATIONS:

Reclassifications were made to the fiscal year 1997 financial statements to conform these with the current year presentation.

THE COMMONWEALTH OF PUERTO RICO

JUDICIARY RETIREMENT SYSTEM

SCHEDULE OF FUNDING PROGRESS

(Dollars amounts in thousands)

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Plan Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>UAAL as a Percentage of Annual Covered Payroll</u>
7/1/98	\$67,200	595,600	\$28,400	70%	518,000	158%
7/1/97	57,300	76,500	19,200	75%	18,000	107%
7/1/96	50,000	63,100	13,100	79%	16,600	79%
7/1/95	42,100	60,800	18,700	69%	15,800	118%
7/1/94	35,600	58,900	23,300	60%	12,600	185%
7/1/93	36,600	57,500	20,900	64%	13,200	158%

The accompanying notes to schedules are an integral part of this schedule.

THE COMMONWEALTH OF PUERTO RICO

JUDICIARY RETIREMENT SYSTEM

NOTES TO SCHEDULES OF TREND INFORMATION

JUNE 30, 1998 AND 1997

1: SCHEDULE OF FUNDING PROGRESS:

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

2: SCHEDULE OF CONTRIBUTIONS:

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

The System's Schedule of Contributions includes both Commonwealth's and participating employees' contributions as the Commonwealth contributions, ultimately, should cover any deficiency between the participating employees' contributions and, the pension benefits and the Systems' administration costs.

3: ACTUARIAL DATA:

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

Valuation Date	July 1, 1998
Actuarial Cost Method	Projected unit credit cost method
Amortization Method	Level percentage of the projected payroll
Remaining Amortization Period	28 years
Asset Valuation Method	Market value
Actuarial Assumptions:	
Investment rate of return*	8.5%
Projected salary increases*	5%
Cost of living adjustment	3%, every three years

*Includes inflation at 3.5%

THE COMMONWEALTH OF PUERTO RICO

JUDICIARY RETIREMENT SYSTEM

SCHEDULE OF CONTRIBUTIONS

(Dollars amounts in thousands)

<u>Year Ended</u> <u>June 30</u>	<u>Annual Required</u> <u>Contribution</u>	<u>Contributions</u>	<u>Percentage</u> <u>Contributed</u>
1998	\$2,800	\$6,100	218%
1997	1,900	5,900	311%
1996	2,400	5,500	229%
1995	2,700	4,600	170%
1994	2,600	4,300	165%
1993	2,600	4,100	158%

The accompanying notes to schedules are an integral part of this schedule.