

*Audited Financial Statements*

*Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities*

*June 30, 2001*

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Audited Financial Statements

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**Contents**

Audited Financial Statements

Report of Independent Auditors.....	1
Statements of Plan Net Assets .....	2
Statements of Changes in Plan Net Assets .....	3
Notes to Financial Statements.....	4

Supplemental Information and Required Supplementary Information

Schedule of Contributions.....	18
Schedule of Funding Progress.....	19
Notes to Schedules of Trend Information .....	20

## Report of Independent Auditors

The Board of Trustees  
Employeess' Retirement System of  
the Government of Puerto Rico  
and its instrumentalities

We have audited the accompanying statement of plan net assets of the Employeess' Retirement System of the Government of Puerto Rico and its Instrumentalities (the System) as of June 30, 2001, and the related statement of changes in plan net assets for the year 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 audit. The financial statements of the System as of June 30, 2000, were audited by other auditors whose report dated December 22, 2000, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2001 financial statements referred to above present fairly, in all material respects, the net assets of the System at June 30, 2001, and the changes in its net assets for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplemental schedules of employer contributions and funding progress are presented for purposes of complying with requirements of the Governmental Accounting Standards Board, and are not a required part of the basic financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information contained in the supplemental schedules and, therefore, express no opinion on it.

*Ernst & Young LLP*

October 4, 2001

Stamp No. 1770130  
affixed to the  
original copy  
of this report.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Statements of Plan Net Assets

	June 30	
	2001	2000
<b>Assets</b>		
Cash and investments:		
Cash and cash equivalents	\$ 32,932	\$ 39,177
Cash deposited with Government Development Bank for Puerto Rico:		
Unrestricted	79,211	45,455
Restricted	489	633
	112,632	85,265
Securities lending, collateral invested	69,866	-
Marketable securities at fair value:		
Bonds and notes	110,364	93,313
Stocks	1,265,391	1,560,035
Mortgage notes acquired from third parties	611	1,393
Alternative investments	36,314	37,622
	266,377	257,053
Loans to plan members:		
Mortgage	63,662	65,561
Personal	191,586	181,085
Cultural trips	11,129	10,407
	266,377	257,053
Investment in PRFA Holdings, at appraised value	701,000	
Accounts receivable:		
Employers	29,735	27,043
General Fund of the Government of Puerto Rico	9,259	4,499
The Commonwealth of Puerto Rico		
Judiciary Retirement System	1,908	1,751
Investment sales	5,134	2,494
Accrued interest	2,527	3,247
Other	8,049	11,724
	56,612	50,758
Property and equipment, net	8,267	8,151
Other assets	16,586	16,402
<b>Total assets</b>	<b>2,644,020</b>	<b>2,109,992</b>
<b>Liabilities</b>		
Securities lending, collateral due to borrowers	69,866	-
Book overdraft	92,886	16,977
Escrow funds of mortgage loans and guarantee insurance reserve for loans to plan members	17,738	17,631
Investment purchases	5,812	8,170
Other liabilities	29,054	25,448
<b>Total liabilities</b>	<b>215,356</b>	<b>68,226</b>
 Net assets held in trust for pension benefits	 <b>\$2,428,664</b>	 <b>\$2,041,766</b>

*See accompanying notes.*

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Statements of Changes in Plan Net Assets

	Year ended June 30	
	2001	2000
	<i>(In Thousands)</i>	
Additions:		
Contributions:		
Employers	\$ 342,767	\$ 298,915
Participating employees	245,221	218,342
Special Laws	14,211	10,182
Special Contribution - PRTA Holdings	701,000	-
	<u>1,303,199</u>	<u>527,439</u>
Investment income:		
Net (depreciation) appreciation in investments reported at fair value	(301,872)	236,218
Dividend income	5,379	9,648
Interest income	50,345	39,700
	<u>(246,148)</u>	<u>285,566</u>
Less investment expense	5,755	5,930
	<u>(251,903)</u>	<u>279,636</u>
Other income	20,512	11,276
Total additions	<u>1,071,808</u>	<u>818,351</u>
Deductions:		
Annuities	606,589	562,309
Special	14,211	10,182
Death benefits	10,773	9,811
Refunds:		
Employers	1,223	1,226
Participating employees	22,622	21,937
	<u>23,845</u>	<u>23,163</u>
Administrative expenses	28,404	27,562
Other expenses	1,088	1,089
Total deductions	<u>684,910</u>	<u>634,116</u>
Net (decrease) increase in assets held in trust for pension benefit	386,898	184,235
Net assets held in trust for pension benefits:		
Beginning of year	<u>2,041,766</u>	<u>1,857,531</u>
End of year	<u>\$2,428,664</u>	<u>\$2,041,766</u>

See accompanying notes.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements

June 30, 2001

**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 began operations on January 1, 1952, at which date contributions by employers and participating employees 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 participating employees and one pensioner, who are appointed by the Governor of the Commonwealth, and four Commonwealth government agency 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 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 employers' 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 accounting principles generally accepted in the United States 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 loan holders to be used by Banco Popular de Puerto Rico, the mortgage service, in the servicing of loan escrows.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

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

**Investments**

Investments are carried at fair value, except for certain mortgage notes, which do not have readily determinable fair values. 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.

Mortgage notes acquired from third parties are held to maturity and are not readily marketable. Consequently, these are carried 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, plan members' contributions and any unrestricted amount remaining in the escrow funds. Maximum amounts that may be granted to plan members for mortgage, personal and cultural trip loans are \$100,000, \$3,000 and \$5,000, respectively. The carrying value of these loans approximates their fair value.

On September 30, 1999, the System sold mortgage loans with a principal balance of approximately \$9,766,000 to a commercial bank at a loss of approximately \$63,000. The agreement stipulates that if during the first 18 months any loan becomes delinquent for over 120 days, the System should repurchase from the buyer such mortgage loan. As of June 30, 2001, the System had not repurchased any of these loans. In addition, as of June 30, 2001 and 2000, the System had repurchased approximately \$168,000 and \$48,000, respectively, in mortgage loans that were sold during fiscal year 1998 to Federal National Mortgage Association (FNMA). The sale contract stipulates that the System must repurchase any loans with payments in arrears over 90 days.

The System services mortgage loans with principal balances of approximately \$35,410,000 and \$42,000,000 at June 30, 2001 and 2000, respectively, related to certain mortgage loans sold to FNMA for a fee of 0.25%. The Income for 2001 amounted \$109,332 and is recognized as Interest Income in the accompanying Statement of Changes in Plan Net Assets.

**Guarantee Insurance Reserve**

Premiums collected and benefits claimed are recorded as additions and deductions of the guarantee insurance reserve, respectively.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

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

**Reclassifications**

Certain amounts from fiscal year 2000 have been reclassified to conform with the current year's presentation.

**2. Plan Description**

The System is a cost-sharing multi-employer defined benefit plan sponsored by the Commonwealth. Substantially all full-time employees of the Commonwealth and its Instrumentalities (including the System) are covered by the System under the terms of the Act No. 447 of 1951. All regular, appointed and temporary employees of the Commonwealth at the date of employment become plan members of the System. The System is optional for members of the Cabinet of the Governor and Heads of Agencies. At June 30, 2001 and 2000, membership consisted of the following:

	<u>2001</u>	<u>2000</u>
Retirees and beneficiaries currently receiving benefits	87,086	82,000
Current participating employees	151,060	150,000

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

**Retirement Annuity**

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

**Policemen and Firemen:**

Age 50 with 25 years of credited service  
30 years of credited service or age 58  
with 10 years of credited service

**Other Employees:**

Age 55 with 25 years of credited service,  
30 years of credited service of age 58  
with 10 years of credited service

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 highest 36 months of compensation recognized by the System. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75% of the average compensation.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**2. Plan Description (continued)**

**Merit Annuity**

Plan members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65% and a maximum of 75% of the average compensation.

**Deferred Retirement Annuity**

A participating employee who ceases to be an employee of the Commonwealth after having accumulated a minimum of ten years of credited service qualifies for retirement benefit provided his/her contributions to the System are left within the System until attainment of 58 years of age.

**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 life annuity payments would start after the death of the retiree for an amount not less than \$240 yearly or greater than the annuity payments being received by the retiree.

**Occupational Disability Annuity**

A participating employee, who as a direct result of the performance of his/her occupation is totally and 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.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**2. Plan Description (continued)**

**Occupational: (continued)**

- Children - \$10 per month for each child, minor or student, up to a maximum benefit per family of 100% 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 - 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 surviving spouse age 60 or over and child, 18 or under, up to 30% (60%, if not covered under Title II of the Social Security Act) 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. On September 2, 2000, an amendment to Article 2-113 of Act No. 447 of May 15, 1951 was made to increase the minimum to \$750 to all cases in which the death date is on or after July 1, 2000.

**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 thereon.

**Amendments to Benefits Payable to Plan Members Who Joined the System on or After April 1, 1990**

Act No.1 of 1990 made certain amendments applicable to new participating employees joining the System effective April 1, 1990. These changes consist principally of an increase in the retirement age from 58 to 65, a decrease in the benefit percentage of the average compensation in the occupational disability and occupational death benefits annuities from 50% to 40%, and the elimination of the Merit Annuity for participating employees who have completed 30 years of creditable service.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**2. Plan Description (continued)**

**Amendments to Benefits Payable to Plan Members Effective January 1, 1998**

Act No. 10 of 1992 provides, subject to the approval of the Legislature, for increases of 3% every three years, of the pensions paid by the System to those plan members with three or more years of retirement. On August 9, 1998, Act No. 221 was approved which provides, retroactively to January 1, 1998, for increases of the pensions paid by the System to those plan members with three or more years of retirement.

**Early Retirement**

On July 28, 1998 Act No. 182 was approved, which provides that effective March 31, 1998, plan members are eligible for early retirement upon attaining age 55 with 25 year of service or 30 years of service but under 55 years of age. Those who select early retirement under these conditions will receive monthly benefits equal to 75% of their average compensation, which is computed based on the highest 36 months of compensation recognized by the System. Plan members may also elect an alternative early retirement annuity upon attaining 25 years of service but less than 55 years of age. Under this election, plan members will receive monthly benefits equal to 65% of their average compensation. In these cases, the employer will contribute to the System an additional amount to cover the benefit payments until the participant reaches the normal retirement age.

On August 12, 2000, Act. No. 174 was approved to allow certain participants to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they make 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 services and age 50) or benefits of 65% (if 25 years of service but less than age 55) if their average compensation which is computed based on the highest 36 month of operation recognized by the system. In these cases, the employer is responsible for contributing to the system amounts to cover the benefit payments and the employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

**Amendment to Act No. 447 Effective January 1, 2000**

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension program (System 2000).

System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, may elect either to stay in the defined benefit plan or transfer to System 2000. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**2. Plan Description (continued)**

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 pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System'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 granted under System 2000. The employers' contributions (9.275% of the employee's salary) with respect to employees under system 2000 will continue and will be used to fund the current plan.

System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

As of June 30, 2001 and 2000, membership consisted of the following:

	2001	2000
Retirees and beneficiaries currently receiving benefits	1	-
Current participating employees	9,604	1,898

**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 been accrued under the plan shall be non-forfeitable to the extent funded.

**3. Funding Policy**

The contribution requirement to the System is established by law and is not actuarially determined. Required employers contributions consist of 9.275% of applicable payroll in the cases of municipalities, central government and public corporations. Required employee contribution consists of 5.775% of the first \$550 of the monthly salary with the excess at 8.275% or 8.275% of the total monthly salary for participating employees' contributions. Commonwealth contributions should ultimately cover any deficiency between the participating employees' contributions and the System's pension benefit obligations and administrative costs.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**3. Funding Policy (continued)**

The special contributions of approximately \$14,211,000 and \$10,182,000 in 2001 and 2000, respectively, represent the reimbursement to the System of the benefits paid on behalf of the General Fund to the Commonwealth under the provisions 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, 2000 and 1999, 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; and (c) assumed mortality rate based on the Group Annuity Table for 1951.

The actuarial accrued liability as of June 30, 2000 and 1999 was approximately \$9,459,300,000 and \$8,308,000,000, respectively. At June 30, 2000 and 1999, the unfunded actuarial accrued liability was approximately \$7,417,500,000 and \$6,450,000,000, respectively.

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 participating employees by increasing the age from 58 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 participating employees from 50% to 40% (see Note 2). In addition, participation in System 2000 will be required for all participants who start working for the Commonwealth effective January 1, 2000 (see Note 2).

As an employer, the System has contributed \$1,116,000 and \$976,000, which represented its contractually required contribution for the years ended June 30, 2001 and 2000, respectively.

**4. Cash and Investments**

**Cash Deposits**

At June 30, 2001, the aggregate carrying amount of cash deposits and cash equivalents held by the System was approximately \$112.6 million, which includes \$84.4 million at commercial banks and an overdraft of \$92.8 million with the Government Development Bank for Puerto Rico (GDB).

The remaining balance of \$28.2 million is insured by the Federal Deposit Insurance Corporation or collateralized with securities held on behalf of the System by the Secretary of the Treasury of the Commonwealth of Puerto Rico, or the Secretary's agent in the name of the Secretary.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**4. Cash and Investments (continued)**

**Cash Deposits (continued)**

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

As of June 30, 2001, cash consists of deposits in banks and is categorized following the "Guide to Implementation of GASB Statement 3 on Deposits with Financial Institutions. Investments (including Repurchase Agreements), and Reverse Repurchase Agreements." The categories for deposits are the following:

Category 1 - insured or collateralized with securities held by the financial institution or by its agent in the System's name.

Category 2 - collateralized with securities held by the pledging financial institution's trust department or its agent in the System's name.

Category 3 - uncollateralized.

The carrying amount of the deposits approximates their fair value. The following presents the deposits categorized (in millions):

	Category		Bank Balance	Carrying Amount
	1	3		
Deposits in commercial banks	\$28.2	\$ -	\$ 28.2	\$ 28.2
Less: Overdraft in GDB	-	84.4	84.4	84.4
	\$28.2	\$84.4	\$112.6	\$112.6

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

4. Cash and Investments (continued)

**Investments**

The following table shows the cost and market value of the investments in marketable securities held by the System as of June 30, 2001 and 2000.

	2001		2000	
	Cost	Fair Value	Cost	Fair Value
(In Thousands)				
U.S. Government and agencies' securities	\$ 20,958	\$ 21,382	\$ 20,902	\$ 30,051
Corporate bonds	85,672	88,982	62,855	63,262
Total Bonds and Notes	106,630	110,364	83,757	93,313
Domestic corporate stocks	963,534	1,040,177	1,017,105	1,278,081
International corporate stocks	279,555	225,814	257,600	281,954
Total Stocks	1,243,089	1,265,391	1,274,705	1,560,035
Alternative investments	43,727	36,314	37,622	37,622
Total Investments	<u>\$1,393,446</u>	<u>\$1,412,069</u>	<u>\$1,367,462</u>	<u>\$1,690,970</u>

*Alternative Investments* include \$30,837,210 and \$34,357,000 as of June 30, 2001 and 2000, respectively, in Guayacán Funds (the Funds). The Funds are limited partnership that invest in United States and International private equity investment partnership, which in turn, invest in equity and equity related investments. The System's commitment in the Funds amounts to \$55,000,000.

The Credit Risk categories for investments are:

Category 1 - Insured or registered in the entity's name, or securities held by the entity or its agent in the entity's name.

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name.

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the entity's name.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

4. Cash and Investments (continued)

Investments (continued)

Risk Classification is as follows:

	Category 1 - 2 - 3	Carrying Amount
Bonds and Notes	\$ 110,364	\$ 110,364
Stocks	1,265,391	1,265,391
Alternative Investments	36,314	36,314
	\$1,412,069	\$1,412,069

The System may issue Collateralized Promissory Notes (the Notes) to generate additional funds to carry out the investment objectives and to improve the investment portfolio. The Notes cannot exceed, in an aggregate principal amount, \$400,000,000 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 are secured by a pledge on the System's securities. GDB acts 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 issues and sells the Notes through brokers and records 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 pays a commission from the proceeds of the Notes to these brokers. At June 30, 2001 there were no notes outstanding.

**Securities Lending Transactions**

During the year the System entered into securities lending transactions. The Citibank as agent manages the securities lending program and receives liquid collateral. The collateral requirement is equal to 102.1% of the fair value of the security lent.

Securities lending obligations for which collateral was received as of June 30, 2001 consist of (expressed in thousands):

Securities Lent	Fair Value of Securities
Corporate Bonds	\$ 4,205
Equity Securities	64,204
	\$68,409

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**4. Cash and Investments (continued)**

**Securities Lending Transactions (continued)**

Collateral received amounted to \$69,866 million and it was invested as follows, \$19.3 million in commercial paper and \$50.5 million in repurchase agreements.

**5. Investment in PRTA Holdings**

On August 4, 1997, the Senate of Puerto Rico approved law No. 54 which authorized the Government to commence negotiations to sell the Puerto Rico Telephone Company (TELPRI). On June 24, 1998, the Senate and the House of Representatives issued a Joint Resolution to authorize the final sale of 50% plus one share of the stock of TELPRI to a joint venture created between Verizon and Banco Popular de Puerto Rico and, to destinate the use of the sale proceeds.

In the same resolution, it was established that the shares of TELPRI's common stock that was not going to be sold on the closing date of the first sale, as defined in the Resolution, should be transferred to the Governmental Development Bank (GDB), and further, it also instructed GDB to create a subsidiary to hold and dispose of that stock for the benefit of the Puerto Rico Public Employee's Retirement System (PRPERS). The sale took place on March 2, 1998. After the sale, the Government retained 43% of TELPRI's stock.

Consequently, GDB created a subsidiary, known as PRTA Holdings and transferred the shares representing the interest in TELPRI retained by the Government to that subsidiary. On December 28, 2000, PRTA Holdings issued and assigned its non-cummulative, non-voting preferred stock to the System, which entitles the System to receive the benefits that TELPRI's stock would generate in the future. PRTA Holdings' capital structure consist of 100 common stock at \$0.01 each owned by GDB and 100 preferred stock, non convertible, non voting, owned by the System. As established by the Articles of Incorporation of PRTA Holdings, the product of the future sale of any shares of the TELPRI stock and any dividends declared by TELPRI will benefit the System.

During the quarters ended June 30, 2001 and September 30, 2001, the System received \$7.6 million and \$9.5 million, respectively, consisting of the dividends declared and paid by TELPRI in those quarters.

The System estimates that as of June 30, 2001, the total estimated value of PRTA Holdings approximates \$701 million. The estimated value of PRTA Holdings preferred stock was recognized as a Special Contribution.

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**5. Investment in PRTA Holdings (continued)**

The total value of PRTA Holdings preferred stock was estimated considering estimated value of TELPRI stock following two factors:

- a. In connection with the first sale of the TELPRI's stock on March 2, 1998, an option was granted to Verizon, to purchase an additional 15% of the TELPRI's stock at a fixed price of \$45.94, expiring on March 2, 2002. The total proceeds that could be realized from the exercise of this option amounted \$172 million.
- b. The remaining 28% of TELPRI stock represents approximately 7 million shares at \$75.64 per share, according to the last stock valuation performed by an independent appraiser for a total of \$529,480,000.

**6. Property and Equipment, Net**

Property and equipment, net acquisitions are recorded at cost. Depreciation is provided using the straight-line method over the useful life of the asset.

At June 30, 2001 and 2000, property and equipment, net consisted of the following:

	Estimated Useful Life	2001	2000
<i>(In Thousands)</i>			
Land	0	\$ 969	\$ 969
Building	50 years	7,631	7,631
Furniture and equipment	5 - 10 years	9,771	8,957
		<u>18,371</u>	<u>17,557</u>
Less accumulated depreciation		10,104	9,406
		<u>\$ 8,267</u>	<u>\$ 8,151</u>

**7. Other Assets**

At June 30, 2001 and 2000, other assets consisted of the following:

	2001	2000
<i>(In Thousands)</i>		
Repossessed and in-substance foreclosed properties	\$ 2,086	\$ 1,902
Excuted land	14,500	14,500
	<u>\$16,586</u>	<u>\$16,402</u>

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

**7. Other Assets (continued)**

Reposessed 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, are not material. Management believes that the carrying value of these properties approximates its fair value.

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. In 1999, the System rented this land to a third party that operated it as a parking facility. Rental income for 2001 and 2000 amounted to approximately \$62,000 and \$68,000, respectively, and is reflected as part of other income in the accompanying statements of changes in plan net assets. According to an independent appraisal dated August 1, 2001, the market value of this land approximates \$22,550,000. The System has been informed that a substantial portion of this land will be acquired by other instrumentalities of the Commonwealth.

**8. 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. The 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.

**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.

## Supplemental and Required Supplementary Information

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Notes to Financial Statements (continued)

Schedule of Contributions  
(Dollar amounts in Thousands)

Year Ended June 30	Annual Required Contribution	Contributions	Percentage Contributed
2000	\$890,800	\$527,400	59%
1999	845,000	491,800	58%
1998	777,800	502,100	65%
1997	722,300	454,600	62%
1996	677,200	402,200	59%
1995	608,800	380,700	63%
1994	566,900	353,900	62%

*See notes to schedules of trend information.*

Employees' Retirement System of the Government  
of Puerto Rico and its Instrumentalities

Schedule of Funding Progress  
(Dollar amounts in Thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Annual Covered Payroll	UAAI. as a Percentage of Annual Covered Payroll
7/1/2000	\$2,041,800	\$9,459,300	\$7,417,500	22%	\$2,463,400	301%
7/1/1999	1,858,000	8,308,000	6,450,000	22%	2,575,000	250%
7/1/1998	1,675,000	7,638,000	5,963,000	22%	2,366,000	252%
7/1/1997	1,444,000	6,914,000	5,470,000	21%	2,363,000	231%
7/1/1996	1,230,000	6,320,000	5,090,000	19%	2,223,000	229%
7/1/1995	1,075,000	6,033,000	4,958,000	18%	2,087,000	238%
7/1/1994	954,000	5,542,000	4,588,000	17%	1,867,000	246%

See notes to schedules of trend information.

# Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities

## Notes to Schedules of Trend Information

### 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 employee's contributions as the Commonwealth contributions, ultimately, should cover any deficiency between the participating employees' contributions, the pension benefits and the System's 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, 2000
Actuarial Cost Method	Projected unit credit cost method
Amortization Method	Level percentage of the projected payroll
Remaining Amortization Period	26 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%