

Audited Financial Statements

*The Commonwealth of Puerto Rico
Judiciary Retirement System*

June 30, 2001

The Commonwealth of Puerto Rico
Judiciary Retirement System

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Report of Independent Auditors

The Board of Trustees
The Commonwealth of Puerto Rico
Judiciary Retirement System

We have audited the accompanying statement of plan net assets of the Commonwealth of Puerto Rico Judiciary Retirement System (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 and 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 performed 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 express no opinion on it.

Ernst & Young LLP

October 4, 2001

Stamp No. 1770129
affixed to the
original copy
of this report.

The Commonwealth of Puerto Rico
Judiciary Retirement System

Statements of Plan Net Assets

	June 30	
	2001	2000
	<i>(In Thousands)</i>	
Assets		
Cash and investments:		
Cash and cash equivalents	\$ 2,127	\$ 1,036
Cash deposited with Government Development Bank for Puerto Rico	1,596	2,988
	<u>3,723</u>	<u>4,024</u>
Receivables:		
Accrued interest	388	325
Investment sales	583	1,482
Other	63	477
	<u>1,034</u>	<u>2,284</u>
Securities lending, collateral invested	2,630	-
Marketable securities at fair value:		
Notes and bonds	20,940	19,901
Stocks	46,850	60,103
	<u>67,790</u>	<u>80,004</u>
Mortgage notes acquired from third parties	26	70
Loans to plan members:		
Mortgage	55	20
Personal	234	190
Cultural trips	43	53
	<u>332</u>	<u>263</u>
Total assets	<u>75,535</u>	<u>86,645</u>
Liabilities		
Securities lending, collateral due to borrowers	2,630	-
Due to the employee's retirement system of the Government of Puerto Rico	1,908	1,751
Escrow funds to plan members and guarantee insurance reserve for loans to plan members	144	142
Investment purchases	720	1,895
Others liabilities	50	49
Total liabilities	<u>5,452</u>	<u>3,837</u>
Net assets held in trust for pension benefits	<u>\$70,083</u>	<u>\$82,808</u>

See accompanying notes.

The Commonwealth of Puerto Rico
Judiciary Retirement System
Statements of Changes in Plan Net Assets

	Year ended June 30	
	2001	2000
	<i>(In Thousands)</i>	
Additions:		
Contributions:		
Employer	\$ 5,394	\$ 5,222
Participating employees	2,240	2,094
	7,634	7,316
Investment income:		
Net (depreciation) appreciation in investments reported at fair value	(11,184)	9,299
Dividend income	173	303
Interest income	304	1,473
Less investment expense	(10,707)	11,075
Total additions	341	413
	(3,414)	17,978
Deductions:		
Annuities	8,262	7,705
Administrative expenses	1,049	1,372
Total deductions	9,311	9,077
Net (decrease) increase in net assets held in trust for pension benefits	(12,725)	8,901
Net assets held in trust for pension benefits:		
Beginning of year	82,808	73,907
End of year	\$ 70,083	\$82,808

See accompanying notes.

The Commonwealth of Puerto Rico
Judiciary Retirement System

Notes to Financial Statements

June 30, 2001

1. Organization and Summary of Significant Accounting Policies

Organization

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 approximately \$1,049,000 and \$1,372,000 for the years ended June 30, 2001 and 2000, 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 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.

The Commonwealth of Puerto Rico
Judiciary Retirement System

Notes to Financial Statements (continued)

I. Organization and Summary of Significant Accounting Policies (continued)

Investments

Investments are carried at fair value, except for certain mortgage notes which have no readily determinable fair value. 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.

Mortgages, 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, participants' 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.

During fiscal 1998, the System sold mortgage loans with a principal balance of approximately \$241,400 to Federal National Mortgage Association (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, 2001 and 2000, the System had not repurchased any loans.

Guarantee Insurance Reserve

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

The Commonwealth of Puerto Rico
Judiciary Retirement System

Notes to Financial Statements (continued)

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, 2001 and 2000, membership consisted of the following:

	2001	2000
Retirees and beneficiaries currently receiving benefits	269	269
Current participating employees	346	243

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, for an amount not less than \$120 yearly nor 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 the time of the disability.

The Commonwealth of Puerto Rico
Judiciary Retirement System

Notes to Financial Statements (continued)

2. Plan Description (continued)

Nonoccupational Disability Annuity

A participating employee totally and permanently disabled for causes not related to his/her occupation, and with to less than 10 years of credited service, is eligible for annuity of 30% of the average compensation of the first 10 years of credited services increased by 1% for every additional year or 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 thereon.

The Commonwealth of Puerto Rico
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Notes to Financial Statements (continued)

2. Plan Description (continued)

Amendments to Benefits Payable to Plan Members Effective January 1, 1999

Act No. 177 of 1997 provides, effective January 1, 1999, 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.

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, 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%; and (c) assumed mortality rate based on the Group Annuity Table of 1951.

The actuarial accrued liability was \$135,800,000 and \$118,200,000 as of June 30, 2000 and 1999, respectively. At June 30, 2000 and 1999, the unfunded actuarial accrued liability was approximately \$53,000,000 and \$44,300,000, 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 \$3.7 million, which includes \$1.6 million at the Government Development Bank for Puerto Rico (GDB).

The remaining balance of \$2.1 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.

The Commonwealth of Puerto Rico
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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 institutions 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	\$2.1	\$ -	\$2.1	\$2.1
Deposits in GDB	-	1.6	1.6	1.6
	<u>\$2.1</u>	<u>\$1.6</u>	<u>\$3.7</u>	<u>\$3.7</u>

The Commonwealth of Puerto Rico
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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	\$13,954	\$14,015	\$13,979	\$13,731
Corporate bonds	6,973	6,925	6,611	6,170
Total Bonds and Notes	20,927	20,940	20,590	19,901
Domestic corporate stocks	35,941	39,056	38,756	51,038
International corporate stocks	9,065	7,794	8,815	9,065
Total Stocks	45,006	46,850	47,571	60,103
Total Investments	\$65,933	\$67,790	\$68,161	\$80,004

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.

Credit Risk Classification is as follows:

	Category 1 - 2 - 3	Carrying Amount
Bonds and Notes	\$20,940	\$20,940
Stocks	46,850	46,850
	\$67,790	\$67,790

The Commonwealth of Puerto Rico
Judiciary Retirement System
Notes to Financial Statements (continued)

4. Cash and Investments (continued)

Securities Lending Transactions

During the year the System entered into securities lending transactions. 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 (in thousands):

<u>Securities lent</u>	<u>Fair Value of Securities</u>
Equity securities	\$2,569

Collateral received amounted to \$2.6 million and it was invested as follows, \$18 thousand in commercial paper and \$2.6 million in repurchase agreements.

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.

Supplemental and Required Supplementary Information

The Commonwealth of Puerto Rico
Judiciary Retirement System

Schedule of Contributions
(Dollar Amounts in Thousands)

Year Ended June 30	Contributions Required	Contributions	Percentage Contributed
2000	\$9,200	\$7,300	79%
1999	4,500	7,900	176
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

See notes to schedules of trend information.

The Commonwealth of Puerto Rico
Judiciary Retirement System

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	UAAL as a Percentage of Annual Covered Payroll
7/1/2000	\$82,800	\$135,800	\$53,000	61%	\$25,700	206%
7/1/1999	73,900	118,200	44,300	63	26,300	168
7/1/1998	67,200	95,600	28,400	70	18,000	158
7/1/1997	57,300	76,500	19,200	75	18,000	107
7/1/1996	50,000	63,100	13,100	79	16,600	79
7/1/1995	42,100	60,800	18,700	69	15,800	118
7/1/1994	35,600	58,900	23,300	60	12,600	185

See notes to schedules of trend information.

The Commonwealth of Puerto Rico
Judiciary Retirement System

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's contributions, ultimately, should cover any deficiency between the participating employee's contributions 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 later 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%