
**STATE OF RHODE ISLAND
EMPLOYEES' RETIREMENT SYSTEM
FISCAL YEAR ENDED JUNE 30, 2001**

Ernest A. Almonte, CPA, CFE
Auditor General

State of Rhode Island and Providence Plantations
General Assembly
Office of the Auditor General



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STATE OF RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

- ◆ INTEGRITY
- ◆ RELIABILITY
- ◆ INDEPENDENCE
- ◆ ACCOUNTABILITY

February 27, 2002

JOINT COMMITTEE ON LEGISLATIVE SERVICES:

SPEAKER John B. Harwood, Chairman

Senator William V. Irons
Senator Dennis L. Algieri
Representative Gerard M. Martineau
Representative Robert A. Watson

We have completed our audit of the financial statements of the State of Rhode Island and Providence Plantations Employees' Retirement System for the fiscal year ended June 30, 2001 in accordance with Rhode Island General Laws, Chapters 22-13 and 35-7.

Our report is contained herein as outlined in the Table of Contents.

Sincerely,

Ernest A. Almonte, CPA, CFE
Auditor General

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
FISCAL YEAR ENDED JUNE 30, 2001

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INDEPENDENT AUDITOR'S REPORT

JOINT COMMITTEE ON LEGISLATIVE SERVICES, GENERAL ASSEMBLY
STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS:

We have audited the accompanying statements of plan net assets of the State of Rhode Island and Providence Plantations Employees' Retirement System (the System) as of June 30, 2001 and the related statements 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.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. 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.

As discussed in Note 1(a), the financial statements referred to above present only the plan net assets and changes in plan net assets of the Pension Trust Funds of the State of Rhode Island and Providence Plantations (the State) and are not intended to present fairly the financial position and results of operation of the State, in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with *Government Auditing Standards*, we have also issued a report dated February 8, 2002 on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Schedules of Funding Progress and the Schedules of Contributions from the Employers and Other Contributing Entity on pages 20 and 21 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Ernest A. Almonte".

Ernest A. Almonte, CPA, CFE
Auditor General

February 8, 2002

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

Statements of Plan Net Assets

June 30, 2001

	<u>ERS</u>	<u>MERS</u>	<u>SPRBT</u>	<u>JRBT</u>	<u>Total (Memorandum Only)</u>
Assets					
Cash and cash equivalents <i>(Note 3)</i>	\$ 685,257	\$ 173,461	\$ 180,635	\$ 114,309	\$ 1,153,662
Receivables					
Member contributions	11,466,584	1,489,260	-	-	12,955,844
Employer contributions	9,624,894	1,509,569	-	-	11,134,463
Due from state for teachers	7,568,759	-	-	-	7,568,759
Miscellaneous	1,340,768	195,326	5,511	4,032	1,545,637
Total receivables	<u>30,001,005</u>	<u>3,194,155</u>	<u>5,511</u>	<u>4,032</u>	<u>33,204,703</u>
Investments, at fair value <i>(Note 3)</i>					
Equity in Short-Term Investment Fund	4,322,868	2,652,647	-	-	6,975,515
Equity in Pooled Trust	5,296,571,916	776,856,253	12,354,404	7,886,266	6,093,668,839
Plan specific investments	27,325,594	-	-	-	27,325,594
Total investments before lending activities	<u>5,328,220,378</u>	<u>779,508,900</u>	<u>12,354,404</u>	<u>7,886,266</u>	<u>6,127,969,948</u>
Invested securities lending collateral <i>(Note 3)</i>	<u>381,179,145</u>	<u>55,908,125</u>	<u>889,111</u>	<u>567,552</u>	<u>438,543,933</u>
Property and equipment, at cost, net of accumulated depreciation					
Line of Business System in Development	7,467,544	1,090,313	15,037	9,714	8,582,608
Computer Equipment (net of accumulated depreciation \$134,535)	468,329	68,335	897	582	538,143
Total Property and Equipment	<u>7,935,873</u>	<u>1,158,648</u>	<u>15,934</u>	<u>10,296</u>	<u>9,120,751</u>
Total assets	<u>5,748,021,658</u>	<u>839,943,289</u>	<u>13,445,595</u>	<u>8,582,455</u>	<u>6,609,992,997</u>
Liabilities					
Securities lending liability	381,179,145	55,908,125	889,111	567,552	438,543,933
Accounts and vouchers payable	5,164,143	743,274	11,705	7,507	5,926,629
Total liabilities	<u>386,343,288</u>	<u>56,651,399</u>	<u>900,816</u>	<u>575,059</u>	<u>444,470,562</u>
Net assets held in trust for pension benefits (A schedule of funding progress for each plan is presented on page 20.)	<u>\$ 5,361,678,370</u>	<u>\$ 783,291,890</u>	<u>\$ 12,544,779</u>	<u>\$ 8,007,396</u>	<u>\$ 6,165,522,435</u>

See notes to financial statements.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

Statements of Changes In Plan Net Assets Fiscal Year Ended June 30, 2001

	<i>ERS</i>	<i>MERS</i>	<i>SPRBT</i>	<i>JRBT</i>	<i>Total (Memorandum Only)</i>
Additions					
Contributions					
Member contributions	\$ 120,115,161	\$ 15,858,098	\$ 615,081	\$ 330,424	\$ 136,918,764
Employer contributions	94,280,315	6,092,688	1,819,930	1,163,571	103,356,504
State contributions for teachers	35,365,234	-	-	-	35,365,234
Interest on service credits purchased	972,461	127,465	-	-	1,099,926
Total contributions	250,733,171	22,078,251	2,435,011	1,493,995	276,740,428
Investment income					
Net depreciation in fair value of investments	(833,071,866)	(121,990,923)	(1,755,616)	(1,133,539)	(957,951,944)
Interest	135,380,467	19,623,649	278,766	180,051	155,462,933
Dividends	29,830,012	4,366,801	62,831	40,474	34,300,118
Other investment income	19,179,633	2,806,664	39,289	25,427	22,051,013
	(648,681,754)	(95,193,809)	(1,374,730)	(887,587)	(746,137,880)
Less investment expense	20,180,662	2,952,867	42,299	27,256	23,203,084
Net loss from investing activities	(668,862,416)	(98,146,676)	(1,417,029)	(914,843)	(769,340,964)
Securities Lending					
Securities lending income	11,975,954	1,756,391	27,847	17,777	13,777,969
Less securities lending expense	(10,931,498)	(1,603,339)	(25,498)	(16,276)	(12,576,611)
Net securities lending income	1,044,456	153,052	2,349	1,501	1,201,358
Total net investment loss	(667,817,960)	(97,993,624)	(1,414,680)	(913,342)	(768,139,606)
Total additions	(417,084,789)	(75,915,373)	1,020,331	580,653	(491,399,178)
Deductions					
Benefits					
Retirement benefits	277,319,497	28,669,422	-	76,524	306,065,443
Cost of living adjustment	65,615,147	2,889,175	-	-	68,504,322
SRA Plus (option)	19,280,077	1,309,124	-	-	20,589,201
Supplemental benefits	956,500	-	-	-	956,500
Death benefits post-retirement	2,533,440	626,177	-	-	3,159,617
Death benefits pre-retirement	292,400	92,800	-	-	385,200
Total benefits	365,997,061	33,586,698	-	76,524	399,660,283
Refund of contributions	6,027,280	1,337,479	-	-	7,364,759
Administrative expense	2,662,558	386,016	2,045	908	3,051,527
Total deductions	374,686,899	35,310,193	2,045	77,432	410,076,569
Net increase (decrease)	(791,771,688)	(111,225,566)	1,018,286	503,221	(901,475,747)
Net assets held in trust for pension benefits					
Beginning of year	6,153,450,058	894,517,456	11,526,493	7,504,175	7,066,998,182
End of year	\$ 5,361,678,370	\$ 783,291,890	\$ 12,544,779	\$ 8,007,396	\$ 6,165,522,435

See notes to financial statements.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

1. Plan Descriptions

(a). General

The Employees' Retirement System of Rhode Island (the "System") acts as a common investment and administrative agent for pension benefits to be provided for four defined benefit retirement plans as listed below:

Plan Name	Type of Plan
Employees' Retirement System (<i>ERS</i>)	Cost-sharing multiple-employer defined benefit plan
Municipal Employees' Retirement System (<i>MERS</i>)	Agent multiple-employer defined benefit plan
State Police Retirement Benefits Trust (<i>SPRBT</i>)	Single-employer defined benefit plan
Judicial Retirement Benefits Trust (<i>JRBT</i>)	Single-employer defined benefit plan

Although the assets of the plans are commingled for investment purposes, each plan's assets are accounted for separately and may be used only for the payment of benefits to the members of that plan, in accordance with the terms of that plan.

The System's financial statements are included as Pension Trust Funds within the Trust and Agency Funds in the Comprehensive Annual Financial Report of the State of Rhode Island and Providence Plantations.

The System is administered by the State of Rhode Island Retirement Board which consists of 15 members: the general treasurer; the director of administration or his or her designee; the budget officer or his or her designee; the fiscal advisor to the house finance committee or his or her designee; the president of the league of cities and towns or his or her designee; two (2) active State employee members of the retirement system or officials from state employee unions to be elected by active State employees; two (2) active teacher members of the retirement system or officials from a teachers union to be elected by active teachers; one active municipal employee member of the retirement system or an official from a municipal employees union to be elected by active municipal employees; one retired member of the retirement system to be elected by retired members of the System; the chairperson of the house finance committee or his or her designee; the chairperson of the senate finance committee or his or her designee; and two (2) public representatives, one of whom shall be a C.L.U. competent in the area of pension benefits, shall be appointed by the governor and whose term shall be for four (4) years, or until their successors are appointed.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

1. Plan Descriptions

(a). General (continued)

The System's purpose is to provide retirement benefits to state employees, public school teachers, general municipal employees, public safety employees, state police officers and judges.

A summary of membership in the plans as of the June 30, 2000 actuarial valuation is listed below:

	<i>Retirees and beneficiaries</i>	<i>Terminated plan members entitled to but not yet receiving benefits</i>	<i>Active Vested</i>	<i>Active Non- vested</i>	<i>Total by Plan</i>
<u>ERS</u>					
State Employees	9,250	1,730	8,916	4,389	24,285
Teachers	6,486	1,245	7,351	6,256	21,338
<u>MERS</u>					
General Employees	3,214	959	2,693	3,517	10,383
Public Safety	270	31	470	551	1,322
<u>SPRBT</u>					
	-	-	-	152	152
<u>JRBT</u>					
	-	-	-	31	31
<i>Total by type</i>	19,220	3,965	19,430	14,896	57,511

(b). Membership and Benefit Provisions

(1) Employees' Retirement System (ERS)

The ERS was established under section two of chapter 2334 of the Rhode Island Public Laws of 1936 and placed under the management of the Retirement Board for the purpose of providing retirement allowances for employees of the State of Rhode Island under the provisions of chapters 8 to 10, inclusive, of title 36, and public school teachers under the provisions of chapters 15 to 17, inclusive, of title 16 of the Rhode Island General Laws.

The plan covers most State employees other than certain personnel at the State colleges and university (principally faculty and administrative personnel). Elected officials may become members on an optional basis. Membership in the plan is compulsory for teachers, including superintendents, principals, school nurses, and certain other school officials in the public schools in the cities and towns. Rhode Island Airport Corporation (RIAC) employees hired before July 1, 1993 are also covered and have the same benefits as State employees. Rhode Island Economic Development Corporation

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

1. Plan Descriptions

(b). Membership and Benefit Provisions (continued)

(RIEDC) employees who were (1) active contributing members and employees of the Department of Economic Development of the State of Rhode Island before October 31, 1995, and (2) elected to continue membership in the plan are also covered and have the same benefits as State employees. Narragansett Bay Water Quality District Commission employees who are members of a collective bargaining unit are also covered and have the same benefits as State employees.

The plan provides unreduced benefits of 1.7% of earnings for each of the first ten years of service; 1.9% for each of the next ten years; 3.0% per year for each of the next fourteen years; and 2% for the 35th year. Joint and survivor options are available as well as the Service Retirement Allowance (SRA) Plus option that provides for the payment of a larger benefit before the attainment of age sixty-two (62) and a reduced amount thereafter. The reduced amount is equal to the benefit before age sixty-two (62), including cost-of-living increases, minus the member's estimated social security benefit payable at age sixty-two (62). The maximum benefit is 80% of final average earnings after 35 years of service. Such benefits are available to members at least age 60 with 10 years of service, or after 28 years at any age. A different benefit formula applies to State correctional officers who may retire at age 50 if they have 20 years of service. Benefits for all employees are based on the average of the highest three consecutive years' earnings, exclusive of overtime.

On the third January after retirement, a cost-of-living increase of 3% (compounded annually) is provided independent of actual changes in the consumer price index. The plan also provides nonservice-connected disability benefits after five years of service; service-connected disability pensions with no minimum service requirement; vested benefits after ten years of service; survivor's benefits for service-connected death; and certain lump sum death benefits.

The plan also provides benefits to legislators elected to office prior to January 1, 1995, of \$600 for every year served up to a maximum of \$12,000. Such benefits are available to legislators 55 and over with at least 8 years of service or, at any age with 20 or more years of service.

The plan provides a survivor benefit to public school teachers via a "Teachers Survivor Benefits Fund" in lieu of Social Security. Not all school districts participate in the plan. The cost of the benefits provided by the plan are two percent (2%) of the member's annual salary up to but not exceeding an annual salary of \$9,600; one-half (1/2) of the cost is contributed by the member by deductions from his or her salary, and the other half (1/2) is contributed and paid by the respective city, town, or school district by which the member is employed. These contributions are in addition to the contributions required for regular pension benefits.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

1. Plan Descriptions

(b). Membership and Benefit Provisions (continued)

Spouse, parents, family and children benefits are payable following the decease of a member. A spouse shall be entitled to benefits upon attaining the age of sixty (60) years. Children's benefits are payable to the child, including a stepchild or adopted child of a deceased member if the child is unmarried and under the age of eighteen (18) years or twenty-three (23) years and a full time student, and was dependent upon the member at the time of the member's death. Family benefits are provided if at the time of the member's death the surviving spouse has in his or her care a child of the deceased member entitled to child benefits. Parents benefits are payable to the parent or parents of a deceased member if the member did not leave a widow, widower, or child who could ever qualify for monthly benefits on the member's wages and the parent has reached the age of 60 years, has not remarried, and received support from the member.

The Teachers Survivor Benefits Fund provides benefits based on the highest salary at the time of retirement of the teacher. Benefits are payable in accordance with the following table:

<u>Highest Annual Salary</u>	<u>Spousal Monthly Minimum Benefit</u>
\$17,000 or less	\$600
\$17,001 to \$25,000	\$700
\$25,001 to \$33,000	\$800
\$33,001 to \$40,000	\$900
\$40,001 and over	\$1,000

Benefits payable to children and families are equal to the spousal benefit multiplied by the percentage below:

Parent and 1 Child	Parent and 2 Children	Parent and more than 2 Children	One Child Alone	Two Children Alone	Three or more Children Alone
150%	175%	175%	75%	150%	175%

(2) Municipal Employees' Retirement System (MERS)

The MERS was established under section one of chapter 2784 of the Rhode Island Public Laws of 1951 and placed under the management of the Retirement Board for the purpose of providing retirement allowances to employees of municipalities, housing authorities, water and sewer districts, and municipal police and fire persons that have elected to participate.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

1. Plan Descriptions

(b). Membership and Benefit Provisions (continued)

The plan generally provides retirement benefits equal to 2% of a member's final average salary multiplied by the number of years of total service up to a maximum of 75%. Joint and survivor options are available as well as the Service Retirement Allowance (SRA) Plus option that provides for the payment of a larger benefit before the attainment of age sixty-two (62) and a reduced amount thereafter. The reduced amount is equal to the benefit before age sixty-two (62), including cost-of-living increases, minus the member's estimated social security benefit payable at age sixty-two (62). Such benefits are available to members at least age 58 with 10 years of service or after 30 years of service at any age. Police and fire personnel may retire at age 55 if they have 10 years of service or after 25 years of service at any age. An optional cost-of-living provision may be elected for police and fire personnel and general employees. An option may be elected to provide a 20 year service pension with a benefit equal to 2.5% for each year of service up to a maximum of 75% for police and fire personnel. Benefits are based on the average of the highest three consecutive years' earnings, exclusive of overtime.

The plan also provides nonservice-connected disability benefits after 5 years of service; service-connected disability pensions with no minimum service requirement; vested benefits after 10 years of service; survivor's benefits; and certain lump sum death benefits. A summary of participating employers is listed below:

Municipalities, housing authorities, water and sewer districts.	64
Municipal police and fire departments.	<u>44</u>
Total participating units as of June 30, 2001	108

(3) State Police Retirement Benefits Trust (SPRBT)

The State Police Retirement Benefits Trust was established under Rhode Island General Laws 42-28-22.1 and was placed under the management of the Retirement Board for the purpose of providing retirement allowances to State Police.

The plan covers all State Police and Superintendents hired after July 1, 1987.

The plan generally provides retirement benefits equal to 50% of final salary after 20 years of service, plus 3.0% of final salary times service in excess of 20 years through 25 years to a maximum of 65% of final salary. Such benefits are available to members after 20 years of service regardless of age. The Superintendent of the State Police will receive 50% of his/her final salary and may retire after attainment of age 60 and 10 years of service. A cost-of-living adjustment of \$1,500 per annum beginning on January 1st of the year in which a member attains his/her third anniversary of retirement is provided to all members. Benefits are based on the final base salary

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

1. Plan Descriptions

(b). Membership and Benefit Provisions (continued)

earned at retirement including longevity increment, holiday pay, clothing allowance and up to 400 overtime hours.

The plan also provides nonservice-connected disability benefits after 10 years of service and service-connected disability pensions with no minimum service requirement.

(4) Judicial Retirement Benefits Trust (JRBT)

The Judicial Retirement Benefits Trust was established under Rhode Island General Laws 8-8.2-7; 8-3-16; 8-8-10.1; 28-30-18.1; and was placed under the management of the Retirement Board for the purpose of providing retirement allowances to Justices of the Traffic Tribunal, Supreme, Superior, Family, District and Workers Compensation courts.

The plan covers all Judges appointed after December 31, 1989.

The plan generally provides retirement benefits equal to 75% of the final salary at the time of retirement after 20 years of service, or 10 years of service and attainment of age 65. Judges retiring after 20 years of service after age 65 or 15 years of service after age 70 will receive full retirement benefits which is the final salary at time of retirement. On the third January after the date of retirement, a cost-of-living increase amounting to 3% not compounded is provided to Supreme, Superior, Family and District Court Judges, independent of actual changes in the consumer price index. Traffic Tribunal and Workers' Compensation Court Judges, on the third January after the date of retirement, receive a cost-of-living increase amounting to 3% compounded annually.

2. Summary of Significant Accounting Policies

These financial statements were prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Governmental Accounting Standards Board (GASB) has the responsibility for establishing generally accepted accounting principles for defined benefit pension plans established by governmental entities. In accordance with GASB Statement No. 20, in the absence of specific guidance from a GASB pronouncement, pronouncements of the Financial Accounting Standards Board (FASB) issued on or before November 30, 1989 have been followed.

Basis of Accounting - The financial statements of the System are prepared on the accrual basis of accounting. Under this method revenues are recorded when earned and expenses are recorded when incurred. Plan member contributions

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

2. Summary of Significant Accounting Policies (continued)

are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan. Dividend income is recorded on the ex-dividend date. Investment transactions are recorded on a trade date basis. The gains or losses on foreign currency exchange contracts are included in income in the period in which the exchange rates change. Gains and losses on contracts which hedge specific foreign currency denominated commitments are deferred and recognized in the period in which the transaction is completed.

Method Used to Value Investments - Investments are recorded in the financial statements at fair value. Fair value is the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller - that is, other than a forced liquidation sale. The fair value of fixed income and domestic and international stocks are generally based on published market prices and quotations from national security exchanges and securities pricing services. Real estate is primarily valued on appraisals by independent appraisers or as adjusted by the general partner. Other securities and investments that are not traded on a national security exchange are valued by the respective fund manager. Unit Investment Trusts (UIT) consist primarily of domestic and international institutional funds. The fair value of the UITs are based on the reported share value of the respective fund. Futures contracts are valued at the settlement price established each day by the board of trade or exchange on which they are traded. Short-term investments are stated at cost which approximates fair value.

Cash and Cash Equivalents - Cash represents cash held in trust in a financial institution. Cash equivalents are highly liquid investments with a maturity of three months or less at the time of purchase.

Property and Equipment - These assets represent the line of business system in development and computer equipment recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives. The line of business system is in development and will not be depreciated until put into use. The computer equipment is depreciated over five years.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

2. Summary of Significant Accounting Policies (continued)

Memorandum Only - Total Columns - Total columns on the financial statements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns are not comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

3. Cash Deposits and Investments

(a). Cash Deposits and Cash Equivalents

At June 30, 2001, the carrying amounts of the plans' cash deposits, including cash overdrafts, are listed below:

	ERS	MERS	SPRBT	JRBT
<i>Book balance</i>	\$ (66,097)	\$ (16,130)	\$ 84	\$ 5
<i>Bank balance</i>	\$ 1,557	\$ 19,377	\$ -	\$ -

The bank balances represent the plans' deposits in short-term trust accounts that are covered by federal depository insurance. At the end of each business day, the excess bank balances are invested in overnight repurchase agreements, which are categorized in the following table as category 1 investments (see Note 3(b). Investments).

In accordance with Rhode Island General Laws, Chapter 35-10.1, depository institutions holding deposits of the State, its agencies or governmental subdivisions of the State, shall at a minimum, insure or pledge eligible collateral equal to one hundred percent of time deposits with maturities greater than sixty days. Any of these institutions that do not meet minimum capital standards prescribed by federal regulators shall insure or pledge eligible collateral equal to one hundred percent of deposits, regardless of maturity. None of the System's deposits were required to be collateralized at June 30, 2001.

(b). Investments

The State Investment Commission oversees all investments made by the State of Rhode Island, including those made for the System. Investment managers engaged by the Commission, at their discretion and in accordance with the investment objectives and guidelines for the System, make certain investments. The General Treasurer makes certain short-term investments on a daily basis. Rhode Island General Laws, Section 35-10-11 (b)(3) requires that all investments shall be made in securities as would be

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

3. Cash Deposits and Investments

(b). Investments (continued)

acquired by prudent persons of discretion and intelligence who are seeking a reasonable income and the preservation of capital.

On July 1, 1992, the State Investment Commission pooled the assets of the ERS with the assets of the MERS for investment purposes only, and assigned units to the plans based on their respective share of market value. On September 29, 1994 and November 1, 1995, the assets of the SPRBT and the JRBT, respectively, were added to the pool for investment purposes only. The custodian bank (State Street Bank) holds most assets of the System in two pooled trusts, Short-term Investment Trust and Pooled Trust. Each plan holds units in the trusts. The number of units held by each plan is a function of each plans' respective contributions to or withdrawals from the trust.

Certain investments are not pooled and are held by only one plan (Plan specific investments). As of June 30, 2001, the ERS held investments in bonds issued by the R.I. Housing and Mortgage Finance Corporation having a fair value of \$3,776,503. This entity is included as a discretely presented proprietary component unit in the State of Rhode Island's Comprehensive Annual Financial Report. The ERS also holds a loan receivable with a fair value of \$22,670,000. This loan is secured by commercial real estate located in Rhode Island.

The System's investments (at fair value) are categorized in the following table to give an indication of the level of risk assumed by the entity at June 30, 2001:

Category 1 includes insured or registered, or securities held by the System or its agent in the System's name.

Category 2 includes uninsured and unregistered, with securities held by the counterparty's trust department or agent in the System's name.

Category 3 includes uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the System's name.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

Notes to Required Supplementary Information

Fiscal Year Ended June 30, 2001

3. Cash Deposits and Investments

(b). Investments (continued)

	<i>Short-term Investment Fund</i>	<i>Pooled Trust</i>	<i>Plan Specific</i>
<i>Investments - Category 1</i>			
U.S. Government and Agency Securities			
Not on securities loan	\$ -	\$ 627,976,068	\$ -
On loan for securities collateral		51,351,640	
Domestic Corporate Bonds and Notes		766,226,223	26,446,503
Foreign Bonds		45,151,311	
Domestic Equity Securities		985,917,562	
Foreign Equity Securities		-	
Not on securities loan		991,100,225	
On loan for securities collateral		580,658	
Unit Investment Trust		1,755,007,434	
Repurchase agreements		1,235,800	
Subtotal	-	5,224,546,921	26,446,503
<i>Investments not categorized</i>			
Real Estate and Alternative Investment Partnerships		318,857,018	
Money Market Mutual Funds	6,902,517	184,081,433	170,914
Investments held by broker-dealers under securities loans with cash collateral			
U.S. Government and Agency Securities		271,773,139	
Domestic Corporate Bonds and Notes		58,951,785	
Foreign Bonds		2,906,108	
Domestic Equity Securities		43,255,446	
Foreign Equity Securities		47,572,189	
Securities lending short-term collateral investment pool		438,543,933	
Subtotal	6,902,517	1,365,941,051	170,914
 Total	 \$ 6,902,517	 \$ 6,590,487,972	 \$ 26,617,417
<i>Reconciliation to investments on Statements of Plan</i>			
Net Assets			
Total above	6,902,517	6,590,487,972	26,617,417
Net investment payable and receivable	72,998	(50,093,252)	708,177
Foreign Cash *		3,167,464	
Domestic Cash *		(10,113,612)	-
Securities lending short-term collateral investment pool		(438,543,933)	
Cash equivalents		(1,235,800)	
Investments on Statements of Plan Net Assets	\$ 6,975,515	\$ 6,093,668,839	\$ 27,325,594

*Deposits at the System's custodian bank, which consist of uncollateralized deposits in foreign banks, are not covered by United States federal depository insurance.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

Notes to Financial Statements

3. Cash Deposits and Investments

(c). Derivatives and Other Similar Investments

Some of the System's investment managers are allowed to invest in certain derivative type transactions, including forward foreign currency transactions, futures contracts and mortgage-backed securities. Through the Unit Investment Trusts (UIT), the System also indirectly holds derivative type instruments. Information on the extent of the use, and holdings of derivative securities by the UITs is not readily available.

Forward Foreign Currency Contracts – The System may enter into foreign currency exchange contracts to minimize the short-term impact of foreign currency fluctuations on foreign investments. These contracts involve risk in excess of the amount reflected in the System's Statements of Plan Net Assets. The face or contract amount in U.S. dollars reflects the total exposure the System has in that particular currency contract. By policy, no more than 50% of actively managed Foreign Equity securities (at fair value) may be hedged into the base currency (US Dollars). The U.S. dollar value of forward foreign currency contracts is determined using forward currency exchange rates supplied by a quotation service. Losses may arise due to changes in the value of the foreign currency or if the counterparty does not perform under the contract.

Futures contracts – The System may use futures to manage its exposure to the stock, money market, and bond markets and the fluctuations in interest rates and currency values. Buying futures tend to increase the System's exposure to the underlying instrument. Selling futures tend to decrease the System's exposure to the underlying instrument, or hedge other System investments. Losses may arise from changes in the value of the underlying instruments, if there is an illiquid secondary market for the contracts, or if the counterparties do not perform under the contract terms.

Mortgage-Backed Securities – The System invests in various mortgage-backed securities, such as collateralized mortgage obligations (CMO), interest-only and principal-only (PO) strips. They are reported in aggregate as U.S. Government and Agency Securities in the disclosure of custodial credit risk. CMO's are bonds that are collateralized by whole loan mortgages, mortgage pass-through securities or stripped mortgage-backed securities. Income is derived from payments and prepayments of principal and interest generated from collateral mortgages. Cash flows are distributed to different investment classes or tranches in accordance with the CMO's established payment order. Some CMO tranches have more stable cash flows relative to changes in interest rates while others are significantly sensitive to interest rate fluctuations.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

Notes to Financial Statements

3. Cash Deposits and Investments

(c). Derivatives and Other Similar Investments (continued)

The System may invest in interest-only (IO) and principal-only strips (PO) in part to hedge against a rise in interest rates. Interest-only strips are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to pre-payments by mortgagees, which may result from a decline in interest rates. Principal-only strips receive principal cash flows from the underlying mortgages. In periods of rising interest rates, homeowners tend to make fewer mortgage prepayments.

Short Sales – The Unit Investment Trusts (UIT) may sell a security they do not own in anticipation of a decline in the fair value of that security. Short sales may increase the risk of loss to the UIT when the price of a security underlying the short sale increases and the UIT is subject to a higher cost to purchase the security in order to cover the position.

(d). Securities Lending

Policies of the State Investment Commission permit use of investments to enter into securities lending transactions. The System has contracted with State Street Bank & Trust Company (SSB) as third party securities lending agent to lend the System's debt and equity securities for cash, securities and sovereign debt of foreign countries as collateral at 102% of the market value of the domestic securities on loan and 105% of the market value of the international securities on loan. There are no restrictions on the amount of loans that can be made. There have been no violations of the provisions of the contract. Securities on loan at year-end for cash collateral are presented as not categorized in the preceding table. Securities on loan for noncash collateral are classified according to the category for the collateral. The contract with the lending agent requires them to indemnify the System if the borrowers fail to return the securities. Either the System or the borrower can terminate all securities loans on demand. The cash collateral received on security loans was invested in the lending agent's short-term investment pool for an average duration of 73 days and a weighted average maturity of 172 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. The System is not permitted to pledge or sell collateral securities received unless the borrower defaults. There were no losses during the fiscal year resulting from default of the borrower or lending agent.

At June 30, 2001, management believes the System has no credit risk exposure to borrowers because the amounts the System owes the borrowers does not exceed the amounts the borrowers owe the System.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

Notes to Financial Statements

3. Cash Deposits and Investments

(d). Securities Lending (continued)

The securities on loan at year-end were \$476,390,965 (fair value), and the collateral received for those securities on loan was \$491,764,265 (fair value).

4. Contributions and Reserves

Contribution requirements for plan members and employers are established pursuant to Rhode Island General Laws. Employers are required to contribute at an actuarially determined rate. Plan member contributions are fixed by statute.

(a). Funding Policy

ERS, SPRBT and JRBT

The funding policy, as set forth in Rhode Island General Laws, Section 36-10-2 provides for actuarially determined periodic contributions to the plans. The Employer's contributions to the plans include (1) normal cost and (2) a payment required to amortize the unfunded frozen actuarial liability of the plans. The ERS' liability is amortized, as of June 30, 1985, over thirty (30) years in multiples of two hundred and fifteen thousandths of one percent (.215%) starting with one multiple in the fiscal year beginning July 1, 1986, and increasing by one multiple in each successive year until the fiscal year ending June 30, 1989; and amortize the remaining unfunded liability of the system as of June 30, 1988, over twenty-seven (27) years beginning in the fiscal year beginning July 1, 1989, calculated such that each year's total unfunded liability payment increases at the assumed rate of inflation over the prior year's total payment. The unfunded liabilities of the SPRBT and JRBT plans are amortized over a 30-year period beginning July 1, 1992. Any subsequent changes to the unfunded liability due to changes to benefits or actuarial assumptions are amortized over a new 30-year period or over the remaining initial amortization period depending on how large the total change to the unfunded liability for each fiscal year is relative to the existing unfunded liability. The normal cost is determined using the frozen entry age cost method.

Effective for the June 30, 1999 valuation, the Rhode Island General Laws were amended to allow the unfunded liabilities of the three plans to be amortized over a 30-year period and to compute normal cost by using the entry age normal cost method. The 1999 valuation is the basis for employer costs in fiscal 2002.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

Notes to Financial Statements

4. Contributions and Reserves

(a). Funding Policy (continued)

MERS

The funding policy, as set forth in Rhode Island General Laws, Section 45-21-42 provides for actuarially determined periodic contributions to the plans. Each employer's contribution to the plans includes normal cost and a payment, where applicable, to amortize the unfunded actuarial accrued liability. The normal cost is determined using the entry age normal cost method. In 1989, the rules regarding the amortizing of the unfunded liability were changed. The new rules provided that the unfunded liability in 1988 will be amortized over the remainder of a 25-year period which commenced on the date the unit joined the plan. Subsequent divergences from the actuarial assumptions are funded over the projected future salaries of active members.

Administrative Expenses

Administrative costs of the System are financed through investment earnings up to a maximum of 1.5% as reported in the audited financial statements for the next preceding fiscal year.

(b). Contributions

The table below displays the contribution rates for the year ending June 30, 2001:

Plan	Employee	Employer
ERS		
State Employees	8.75%	7.99%
Teachers	9.50%	
<i>Municipal funded</i>		6.85% (5.63% for towns not participating in the 1990 early retirement incentive)
<i>State funded</i>		5.16% (4.34% for towns not participating in the 1990 early retirement incentive)
MERS		
General Employees	6.00% (additional 1% with a cost-of-living adjustment)	64 Municipalities, housing authorities, water and sewer districts contributed various actuarially determined rates.
Public Safety	7.00% (additional 1% with a cost-of-living adjustment and /or 1% with a 20 year service plan)	44 Municipal police and fire departments contributed various actuarially determined rates.
SPRBT	8.75%	25.89%
JRBT	8.75%	31.09%

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

Notes to Financial Statements

5. Commitments

The Retirement System has contracted with a systems integration firm to design and build a new pension administration system. The total cost to the System is estimated at \$16.8 million, of which \$9.1 million has been recorded as Property and Equipment. The remaining cost is estimated at \$7.7 million. Full implementation is expected by the second quarter of fiscal 2004. This will be financed in the same manner as other administrative expenses of the System.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

1. Schedules of Funding Progress

Effective with the June 30, 1999 valuation, which was restated, certain actuarial assumptions were changed. Specifically, the actuarial cost method for ERS, SPRBT and JRBT were set to Entry Age Normal and the amortization period was changed to 30 years. The inflation assumption was decreased from 3.5% to 3.0%.

Effective with the June 30, 1999 valuation, the actuarial value of assets was developed using a five-year smoothed market technique for ERS, SPRBT and JRBT.

Effective with the June 30, 1998 valuation, the actuarial value of assets was developed using a four-year moving average technique for ERS, SPRBT and JRBT. The MERS actuarial value of assets was developed using a three-year smoothed market value of assets.

Effective with the June 30, 1997 valuation, certain actuarial assumptions were changed due to an experience study. Specifically, the actuarial value of assets for ERS, MERS, SPRBT and JRBT was reset to equal the fair market value of assets at June 30, 1997. The investment rate of return was increased from 8.00% to 8.25%. Projected salary increases were changed from a fixed percentage to a sliding scale based on age and service. The inflation assumption was increased to 3.5% from 3.0%.

Effective with the June 30, 1996 valuation, the actuarial value of assets for ERS and MERS was reset to equal the market value of assets at June 30, 1996.

Employer costs for fiscal year ending June 30, 2003 is based on the valuation results and data as of June 30, 2000.

The MERS funded ratio is a composite of all units in the plan. The System performs a separate valuation for each unit.

2. Schedules of Employer Contributions

Employer contributions for the ERS plan included in the Schedules of Contributions from the Employers and Other Contributing Entity do not include the Teacher Survivor Benefits as described in Note 1(b) and any employer contributions related to supplemental pension benefits that are attributable and paid by a specific employer. These amounts are not included in the annual required contributions.

The MERS contributions for the fiscal year ended June 30, 1997 include a \$3,843,955 transfer from a new unit joining the plan.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Notes to Required Supplementary Information
Fiscal Year Ended June 30, 2001

2. Schedules of Employer Contributions (continued)

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.

3. Actuarial Assumptions and Methods

	ERS		MERS	SPRBT	JRBT
	State Employees	Teachers			
Valuation Date	6/30/00	6/30/00	6/30/00	6/30/00	6/30/00
Actuarial Cost Method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Amortization Method	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed	<u>Initial base:</u> Level dollar – Closed <u>All subsequent changes:</u> Level Percent of Payroll – Open	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed
Equivalent Single Remaining Amortization Period	29 years	29 years	Various	29 years	29 years
Asset Valuation Method	5 Year Smoothed Market	5 Year Smoothed Market	3 Year Smoothed Market Value	5 Year Smoothed Market	5 Year Smoothed Market
Actuarial Assumptions					
Investment Rate of Return	8.25%	8.25%	8.25%	8.25%	8.25%
Projected Salary Increases	4.25% to 14.25%	4.25% to 16.75%	<u>General Employees</u> 4.25% to 10.25% <u>Police & Fire Employees</u> 5.00% to 15.50%	5.00% to 15.00%	5.50%
Inflation	3.00%	3.00%	3.00%	3.00%	3.00%
Cost of Living Adjustments	3.0% compounded	3.0% compounded	3.0% Non-compounded	\$1,500 per annum	3.0% (see Note 1(b)(4)) to the financial statements



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STATE OF RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

- ◆ INTEGRITY
- ◆ RELIABILITY
- ◆ INDEPENDENCE
- ◆ ACCOUNTABILITY

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

JOINT COMMITTEE ON LEGISLATIVE SERVICES, GENERAL ASSEMBLY
STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS:

We have audited the statements of plan net assets of the State of Rhode Island and Providence Plantations Employees' Retirement System (the System) as of June 30, 2001 and the related statements of changes in plan net assets for the year then ended, and have issued our report thereon dated February 8, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Compliance

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation

of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we will report to the management of the System in a separate communication.

This report is intended solely for the information and use of the members of the Retirement Board, management, and the Joint Committee on Legislative Services, General Assembly, State of Rhode Island and Providence Plantations and is not intended to be and should not be used by anyone other than these specified parties.



Ernest A. Almonte, CPA, CFE
Auditor General

February 8, 2002