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**RHODE ISLAND DEPOSITORS  
ECONOMIC PROTECTION  
CORPORATION**

(A Component Unit of the  
State of Rhode Island)

YEAR ENDED JUNE 30, 2002

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

September 30, 2002

JOINT COMMITTEE ON LEGISLATIVE SERVICES:

SPEAKER John B. Harwood, Chairman

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

We have completed our audit of the financial statements of the Rhode Island Depositors Economic Protection Corporation for the fiscal year ended June 30, 2002 in accordance with Section 42-116-26 of the General Laws.

Our reports are contained herein as outlined in the Table of Contents.

Sincerely,

Ernest A. Almonte, CPA, CFE  
Auditor General

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island)

YEAR ENDED JUNE 30, 2002

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## **INDEPENDENT AUDITOR'S REPORT**

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

BOARD OF DIRECTORS OF THE RHODE ISLAND DEPOSITORS ECONOMIC  
PROTECTION CORPORATION:

We have audited the accompanying statement of net assets of the Rhode Island Depositors Economic Protection Corporation (DEPCO), a component unit of the State of Rhode Island and Providence Plantations, as of June 30, 2002, and the related statement of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of DEPCO'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. 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 financial statements referred to above present fairly, in all material respects, the net assets of DEPCO as of June 30, 2002, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, DEPCO has satisfied all its bonded indebtedness and is obligated by the General Laws to return all proceeds from its operations to the State of Rhode Island. The Board of Directors shall dissolve the Corporation once it has determined the purposes for which it was created have been substantially fulfilled.

As described in Note 2 to the financial statements, DEPCO adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2002 on our consideration of DEPCO's internal control over financial reporting and on 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.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The accompanying schedule of travel and entertainment expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Ernest A. Almonte, CPA, CFE  
Auditor General

September 26, 2002

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island)

**Management's Discussion and Analysis**

Management of the Rhode Island Depositors Economic Protection Corporation ("DEPCO") provides this Management's Discussion and Analysis of their financial performance for the readers of DEPCO's financial statements. This narrative provides an overview of DEPCO's financial activity for the year ended June 30, 2002. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of DEPCO's financial activities based on the status of the corporation currently facing management.

**Understanding DEPCO's Financial Statements**

DEPCO is a component unit of the State of Rhode Island and Providence Plantations ("State") accounted for as a liquidating entity, which reports all assets and liabilities at their market value. In accordance with generally accepted accounting principles, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this discussion and analysis by management reflect the financial position of DEPCO as of June 30, 2002 and the results of its operations and its cash flows for the fiscal year ended June 30, 2002.

DEPCO is charged under Title 42 Chapter 116 of the General Laws of the State with maximizing the return from the sale or other disposition of the assets of the corporation, minimize the impact of such transactions on local real estate and financial markets and to make efficient use of funds obtained from the proceeds of such assets or from the State. Also since DEPCO satisfied by payment, cancellation or defeasance/refund all its bonded indebtedness as of August 3, 2000, net proceeds for DEPCO's operations are to be paid quarterly to the State.

As a liquidating corporation DEPCO's assets, liabilities, revenues and expenses are constantly diminishing. Pursuant to Section 42-116-25 of the General Laws, once DEPCO's Board of Directors has determined that the corporation has completed its stated purpose and has provided for the satisfaction of all its outstanding bonds all remaining assets are to be turned over to the State.

**Financial Highlights for the Year Ended June 30, 2002**

- ❑ DEPCO transferred \$17.5 million cash and \$9,138 in assets to the State.
- ❑ DEPCO collected \$2,456,166 from the collection and reduction of loan obligations and sold one real estate parcel for \$812,726.
- ❑ Net recoveries from the settlement of the last remaining professional and legal malpractice suits were \$3,414,822.
- ❑ The valuation of the remaining loan assets was increased by \$610,000 due to the acquisition of additional collateral and \$896,000 due to payment performance. The valuation of the remaining real estate asset was increased by \$231,000.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
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**Management's Discussion and Analysis**

- Employee expenses were reduced by 44% and asset related expenses, predominately comprised of legal fees, were reduced by 37% respectively from the previous year.

| <b>Assets, Liabilities and Net Assets</b> |                            |                             |
|---|----------------------------|-----------------------------|
|   | <u>June 30, 2002</u>       | <u>June 30, 2001</u>        |
| <b>Assets:</b>                            |                            |                             |
| Cash and Cash Equivalents                 | \$ 1,882,656               | \$ 14,588,731               |
| Loans                                     | 6,669,964                  | 5,601,427                   |
| REO                                       | 465,500                    | 884,501                     |
| Other Assets                              | <u>87,878</u>              | <u>242,217</u>              |
|   | 9,105,998                  | 21,316,876                  |
| <b>Liabilities:</b>                       |                            |                             |
| Accounts payable and accrued expenses     | 251,190                    | 628,109                     |
| Due to the State                          | -0-                        | 1,000,000                   |
| Due to receiverships                      | <u>215,000</u>             | <u>253,215</u>              |
|   | <u>466,190</u>             | <u>1,881,324</u>            |
| <b>Net assets</b>                         | <u><u>\$ 8,639,808</u></u> | <u><u>\$ 19,435,552</u></u> |

DEPCO's remaining assets consist primarily of eighty-seven loans, cash and cash equivalents and one remaining real estate parcel which was sold in July 2002. DEPCO's liabilities consist of accrued expenses and one remaining depositor claim. Under the terms of the June 23, 1992 agreement by and between DEPCO and the Heritage Receivership, DEPCO is liable for the payment of any remaining depositor claims once they have been finally adjudicated. DEPCO also has a loan judgment against the depositor in excess of the deposit claim.

The reduction of assets from the previous year was primarily the result of the transfer of \$17,500,000 cash to the State. This amount consisted of approximately \$5.7 million of net proceeds from fiscal 2002 and the remainder from liquidation activities and settlements received in prior years. The reduction of liabilities was primarily the result of the payment of the previous year liabilities in the current year and the continuing contraction of DEPCO as the pool of assets decreases.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island)

**Management's Discussion and Analysis**

| <b>DEPCO Operations</b>  |                                     |                                     |
|--|-------------------------------------|-------------------------------------|
|  | <b>Year Ended<br/>June 30, 2002</b> | <b>Year Ended<br/>June 30, 2001</b> |
| <b>Revenues</b>  |                                     |                                     |
| Change in recorded value                                       |                                     |                                     |
| Loans  | \$ 3,355,269                        | \$ 6,918,350                        |
| Real Estate owned  | 230,955                             | 328,250                             |
| Net settlements  | 3,414,822                           | 14,980,856                          |
| Gain on sale of real estate, loans<br>and other assets         | 337,071                             | 7,085                               |
| Other revenues   | 83,844                              | 325,860                             |
| Investment income  | 270,590                             | 1,129,349                           |
| Net gain on defeasance and on<br>escrow investment restructure | -0-                                 | 904,749                             |
|  | <u>\$ 7,692,551</u>                 | <u>\$ 24,594,499</u>                |
| <b>Expenses</b>  |                                     |                                     |
| Salaries and employee benefits                                 | \$ 441,562                          | \$ 787,254                          |
| Asset related expenses   | 316,634                             | 500,354                             |
| Other expenses   | 220,961                             | 1,098,161                           |
| Bond financing costs   | -0-                                 | 233,417                             |
| Transfer to the State  | 17,509,138                          | 28,825,508                          |
|  | <u>\$ 18,488,295</u>                | <u>\$ 31,444,694</u>                |
| Change in net assets   | <u>\$ (10,795,744)</u>              | <u>\$ 6,850,195</u>                 |

Change in Net Assets

The reduction in revenues from the prior year is primarily due to the decrease in net settlement recoveries from professional and legal malpractice suits, the difference in the amount of fair value adjustments due to the acquisition of collateral on loans previously determined to have no estimated fair value, the reduction in net gains on escrow investment restructure and the decreased interest income resulting from lower interest rates and less cash on hand.

The reduction in expenses from the prior year is primarily due to the contraction of DEPCO thereby reducing operating expenses. The change in the transfer to the State reflects the reduction in revenues and proceeds available for transfer to the State.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island)

**Management's Discussion and Analysis**

Future Operations

There are currently eight ongoing court cases or collection actions representing thirty-three loans. There are eight bankruptcy actions representing twenty-two loans awaiting either court rulings or distributions from the trustee. There are eleven settlements representing thirty-two loans that are being monitored for compliance to the terms of their settlement. DEPCO is aggressively pursuing all avenues to further reduce the cost of the credit union crisis to the taxpayers. DEPCO projects that there will be net proceeds of \$3.5 million during the next fiscal year to transfer to the State.

Contacting DEPCO's Financial Management

This discussion and analysis presentation is designed to provide a general overview of DEPCO's financial activity. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Executive Director, DEPCO, 832 Dyer Avenue, Cranston, RI 02920.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

STATEMENT OF NET ASSETS

JUNE 30, 2002

ASSETS

|   |                     |
|---|---------------------|
| Cash and cash equivalents (note 3)              | \$ 1,882,656        |
| Accounts receivable                             | 26,997              |
| Loans, at fair value (note 4)                   | 6,669,964           |
| Other real estate owned, at fair value (note 4) | 465,500             |
| Prepaid expenses and other assets               | <u>60,881</u>       |
| Total assets                                    | <u>\$ 9,105,998</u> |

LIABILITIES

|                                       |                |
|---------------------------------------|----------------|
| Accounts payable and accrued expenses | \$ 251,190     |
| Due to receiverships (note 5)         | <u>215,000</u> |
| Total liabilities                     | <u>466,190</u> |

Commitments and contingencies (note 10)

NET ASSETS (note 9) \$ 8,639,808

The accompanying notes are an integral part of these financial statements.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

STATEMENT OF REVENUES, EXPENSES AND  
CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2002

|  |              |
|--|--------------|
| Operating revenues:  |              |
| Gain on sale of other real estate owned, net                       | \$ 161,878   |
| Gain on sale of loans, furniture and equipment                     | 175,193      |
| Change in recorded value of:                                       |              |
| Loans (note 4)   | 3,355,269    |
| Other real estate owned and other assets                           | 230,955      |
| Settlements, net (note 11)   | 3,414,822    |
| Other income   | 83,844       |
| Total operating revenues   | 7,421,961    |
| Operating expenses:  |              |
| Salaries and employee benefits                                     | 441,562      |
| Professional services  | 35,371       |
| Real estate owned and other direct asset-related expenses (Note 4) | 316,634      |
| Other expenses   | 185,590      |
| Total operating expenses   | 979,157      |
| Operating income   | 6,442,804    |
| Nonoperating income (expenses)                                     |              |
| Investment income  | 270,590      |
| Transfers to State (note 6)  | (17,509,138) |
| Change in net assets   | (10,795,744) |
| Net assets, beginning of year                                      | 19,435,552   |
| Net assets, end of year  | \$ 8,639,808 |

The accompanying notes are an integral part of these financial statements.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2002

|   |                     |
|---|---------------------|
| Cash flows from operating activities:             |                     |
| Collections from loans                            | \$ 2,281,166        |
| Proceeds from sale of real estate owned           | 812,726             |
| Proceeds from sale of loans                       | 175,000             |
| Collections of real estate owned sales deposits   | 23,500              |
| Payments to vendors, employees and consultants    | (1,261,767)         |
| Proceeds from legal settlements, net              | 3,296,532           |
| Other   | <u>196,178</u>      |
| Net cash provided by operating activities         | <u>5,523,335</u>    |
| Cash flows from noncapital financing activities:  |                     |
| Transfers to State                                | <u>(18,500,000)</u> |
| Net cash used for noncapital financing activities | (18,500,000)        |
| Cash flows from investing activities:             |                     |
| Investment income received                        | <u>270,590</u>      |
| Net cash provided by investing activities         | <u>270,590</u>      |
| Net decrease in cash and cash equivalents         | (12,706,075)        |
| Cash and cash equivalents, beginning of year      | <u>14,588,731</u>   |
| Cash and cash equivalents, end of year            | <u>\$ 1,882,656</u> |

(continued)

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

STATEMENT OF CASH FLOWS (CONTINUED)

YEAR ENDED JUNE 30, 2002

|   |                     |
|---|---------------------|
| Reconciliation of operating income to net cash provided by operating activities:            |                     |
| Operating income  | \$ 6,442,804        |
| Adjustments to reconcile net operating income to net cash provided by operating activities: |                     |
| Change in recorded value of:  |                     |
| Other real estate owned and other assets  | (230,955)           |
| Loans   | (3,355,269)         |
| Decrease in:  |                     |
| Accounts receivable   | 112,000             |
| Loans   | 2,281,167           |
| Other real estate owned   | 650,001             |
| Prepaid expenses and other assets   | 506                 |
| Due from receiverships  | 38,215              |
| Accounts payable and accrued expenses   | (376,919)           |
| Accrued interest payable, bonds   | -0-                 |
| Due to receiverships  | (38,215)            |
| Net cash provided by operating activities   | <u>\$ 5,523,335</u> |

The accompanying notes are an integral part of these financial statements.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

NOTES TO THE FINANCIAL STATEMENTS  
Year Ended June 30, 2002

**1. BACKGROUND:**

The Rhode Island Depositors Economic Protection Corporation (DEPCO) was created in 1991 under Chapter 42-116 of the Rhode Island General Laws as a public corporation and instrumentality of the State of Rhode Island and Providence Plantations (the State) having a distinct legal existence separate from the State and not constituting a department of State government. DEPCO was created to assist in protecting the interests of depositors of certain credit unions, loan and investment companies and bank and trust companies in the State (collectively, the closed institutions) which had been closed when their private deposit insurer, Rhode Island Share and Deposit Indemnity Corporation (RISDIC), failed on December 31, 1990, thereby leaving those institutions without deposit insurance, which is required by Section 19-11-19 of the Rhode Island General laws.

The General Laws empowered DEPCO to acquire all or a portion of the assets of the closed institutions thereby aiding the repayment of the deposit liabilities of the closed institutions. To provide funds for this and its other corporate purposes, DEPCO may issue bonds, subject to limitations, incur debt collateralized solely by its assets without limit as to amount, dispose of assets acquired, and receive appropriations of a portion of the State's sales tax revenue. DEPCO's bonds payable and other indebtedness are not deemed to be a debt, obligation or a pledge of the full faith and credit of the State.

In connection with DEPCO's plan (the plan) to repay depositors of the closed institutions, DEPCO assumed certain deposit liabilities and acquired all or a portion of the assets of certain closed institutions. Pursuant to its plan, DEPCO acquired assets in June 1992 with a recorded value of approximately \$427,100,000 from the receiverships of certain closed institutions. The acquisition price was equal to the deposit liabilities assumed, which amounted to approximately \$636,700,000. DEPCO also assisted the assumption of deposit liabilities and the acquisition of assets by other financial institutions and assisted in institutions obtaining federal deposit insurance. DEPCO funded these activities through the issuance of special obligation and general obligation bonds. DEPCO used state sales tax appropriations and amounts realized on the sale of assets and other activities to cover operating and interest costs and repay bond obligations and guarantee deposit liabilities.

In accordance with the General Laws, DEPCO received a portion of the State's sales tax revenue (six-tenths of one percent within the existing State sales tax rate) for the period during which DEPCO bonds were outstanding. Due to the final defeasance of all remaining outstanding bonds on August 3, 2000, the agreement between DEPCO and the State regarding payment of a portion of the State sales tax to DEPCO was terminated effective August 28, 2000.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

NOTES TO THE FINANCIAL STATEMENTS  
Year Ended June 30, 2002

**1. BACKGROUND (CONTINUED):**

Effective July 1, 2000, the General Laws (section 42-116-25.1) were amended to require DEPCO, upon final defeasance of all corporation bonds, to pay corporation proceeds from all sources to the State on a quarterly basis. DEPCO makes quarterly payments to the State based upon corporate proceeds available after payment of operating expenses.

DEPCO is obligated, upon termination of the corporation, to return to the State title to all funds and other properties owned by it as a result of its activities as defined in Chapter 42-116 of the Rhode Island General Laws which remain after provision for the payment or satisfaction of all bonds, and other obligations of the corporation. Under Section 25 of RIGL 42-116, the board of directors is responsible for dissolving the corporation once it has determined that the purposes for which it was created have been substantially fulfilled.

DEPCO is governed by a board of directors consisting of the Governor of the State, who serves as Chairman, and four members appointed by the Governor with the advice and consent of the State Senate.

DEPCO is considered a component unit of the State for financial reporting purposes, and accordingly, its financial statements are included in the State's Comprehensive Annual Financial Report.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

*Basis of accounting:*

The financial statements of DEPCO are prepared on the accrual basis of accounting which is appropriate for governmental proprietary fund type activities. The Governmental Accounting Standards Board (GASB) has responsibility for establishing generally accepted accounting principles for governmental proprietary fund type activities. 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.

DEPCO was created to effectively assume the role of a liquidating bank for the closed institutions. As such, certain accounting principles governing liquidating banks are applicable. Loans and real estate owned are carried at their estimated fair values. Liabilities are carried on the statement of net assets at historical cost, as this is the amount at which liabilities are currently anticipated to be settled.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

NOTES TO THE FINANCIAL STATEMENTS  
Year Ended June 30, 2002

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):**

*Cash equivalents:*

DEPCO considers all highly liquid investments, such as repurchase agreements and U.S. Treasury Bills, with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents are recorded at cost plus accrued interest which approximates fair value.

*Loans and other real estate owned:*

Loans and other real estate owned are recorded at estimated fair values. Fair value is the amount that can reasonably be expected to be received in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Estimated fair value is determined by appraisals of individual properties or similar procedures which management believes result in a reasonable estimation of the fair values of the assets and are consistent with the methodology used by appraisers. Such methodology is based on estimated cash flows from the collection, sale, orderly liquidation or other realization of these assets, net of any direct operating expenses and selling costs of the assets. In formulating the estimates, management takes into account economic conditions and specific factors applicable to each asset (for example, financial condition of borrower and guarantor, condition and marketability of collateral or property owned, collection and workout costs and advances, liabilities, bankruptcy and pending litigation, etc.). The estimated cash flows are then discounted at rates believed to result in appropriate market rates of return given the inherent uncertainties associated with these assets. Actual proceeds from the sale, collection or liquidation of assets may differ from the estimated fair values reported as of the balance sheet date.

Amounts realized in excess of or less than carrying value are recorded in the period in which the corresponding asset is sold.

Interest on most loans is included in income as earned based upon interest rates applied to unpaid principal. No interest is accrued when loans are greater than 90 days delinquent. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is charged against current period income. Subsequent cash receipts on nonaccrual loans are applied to the outstanding principal balance of the loan, or recognized as interest income, depending on management's assessment of the ultimate collectibility of the loan. Nonaccrual loans may be returned to full accrual status when principal and interest payments are not delinquent.

DEPCO's loans and other real estate owned are primarily concentrated in the State. Repayment of loans and sales of other real estate owned is in part dependent upon the economic conditions of the area.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

NOTES TO THE FINANCIAL STATEMENTS  
Year Ended June 30, 2002

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued):**

*Use of estimates:*

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Adoption of Governmental Accounting Standards Board Pronouncements:*

DEPCO adopted the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. Statement No. 34 establishes new financial reporting requirements for all state and local governments including component units. For DEPCO, adoption of this pronouncement required inclusion of management’s discussion and analysis to provide an overview of DEPCO’s financial activities and also required changes to the format and terminology used in the financial statements.

**3. CASH AND CASH EQUIVALENTS:**

At June 30, 2002, the carrying amount of DEPCO's cash deposits was \$91,304 and the corresponding bank balance was \$100,000 of which the entire amount was covered by federal deposit insurance.

The State of Rhode Island requires, effective October 1, 1991, that certain uninsured deposits be collateralized. Section 35-10.1-7 of the General Laws of the State of Rhode Island, dealing with the collateralization of public deposits, requires all time deposits with maturities of greater than 60 days and all deposits in institutions that do not meet minimum capital standards as required by its federal regulator must be collateralized. None of DEPCO’s deposits were required to be collateralized.

DEPCO's enabling legislation authorizes it to invest any funds held in reserves, or revenues or funds not required for immediate disbursement, in investments, obligations or securities as authorized for the investment of funds by the State.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

NOTES TO THE FINANCIAL STATEMENTS  
Year Ended June 30, 2002

**3. CASH AND CASH EQUIVALENTS (continued):**

Cash equivalents are classified among 3 categories of credit risk:

Category 1 - cash equivalents and investments that are insured or registered, or held by DEPCO or its agent in DEPCO's name;

Category 2 - cash equivalents and investments that are uninsured and unregistered, and are held by the counterparty's trust department or agent in DEPCO's name;

Category 3 - cash equivalents and investments that are uninsured and unregistered, and are held by the counterparty or its trust department or agent but not in DEPCO's name.

At June 30, 2002, DEPCO's cash equivalent investments totaling \$1,791,352 (at cost which approximates fair value) consisted of repurchase agreements collateralized by U.S. Government and government agency securities. These are Category 2 investments.

**4. LOANS AND OTHER REAL ESTATE OWNED:**

*Loans:*

DEPCO's loans receivable consisted of borrower obligations with principal balances outstanding totaling \$95,893,949 at June 30, 2002. An adjustment of \$89,223,985 has been recorded to reflect these obligations at estimated fair value. The majority of these loan principal balances represent the deficiency resulting from previous foreclosure on collateral. Consequently, most loans are uncollateralized and are on nonaccrual status.

The fair value of these loans reflects the estimated amount that could be realized from sale of the assets or through collection. The estimated fair value takes into account the current financial condition of the borrower and/or guarantor, existence and/or condition of collateral, marketability of collateral and related collection and work out costs. Actual proceeds from the sale, collection or liquidation of assets may differ from the estimated fair values reported as of the balance sheet date.

The change in recorded value of loans for the year ended June 30, 2002 resulted from approximately \$896,000 in fair value adjustment due to collection performance, approximately \$1,849,000 in collections on loans previously determined to have no estimated fair value and approximately \$610,000 in fair value adjustment due to acquisition of collateral on loans previously determined to have no estimated fair value.

*Other real estate owned:*

Other real estate owned consisted of commercial real estate with a fair value of \$465,500 at June 30, 2002.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

NOTES TO THE FINANCIAL STATEMENTS  
Year Ended June 30, 2002

**5. DUE TO RECEIVERSHIPS:**

DEPCO has an obligation to assume deposit liabilities of a closed institution in receivership amounting to \$215,000 at June 30, 2002. The amount is a disputed claim by a Heritage Loan and Investment Bank depositor still being determined by the courts. DEPCO is not required to assume, and payments under DEPCO's plan to pay back depositors are not required to be made, until such time as there are no remaining potential claims against the depositor. DEPCO has the right to assume such liabilities and to offset them against amounts due from the individuals as a result of final judgments and settlements.

**6. TRANSFERS TO THE STATE:**

During fiscal 2002, DEPCO transferred \$17,509,138 to the State which was comprised of the following components:

|  |                      |
|--|----------------------|
| Payments made to the State pursuant to General Law 42-116-25.1 | \$ 17,500,000        |
| Transfer of furniture and equipment and other assets           | <u>9,138</u>         |
| Fiscal 2002 transfers to the State's general fund              | <u>\$ 17,509,138</u> |

Effective July 1, 2000, the General Laws (section 42-116-25.1) were amended to require DEPCO, upon final defeasance of all corporation bonds, to pay corporation proceeds from all sources to the State on a quarterly basis. DEPCO makes quarterly payments to the State based upon corporate proceeds available after payment of operating expenses.

**7. DEFEASANCE OF DEBT:**

At June 30, 2002, \$550,305,000 of special obligation bonds remain outstanding but are considered defeased and/or refunded through deposit of U.S. Government Securities in irrevocable trusts to provide for all future debt service payments on the bonds.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

NOTES TO THE FINANCIAL STATEMENTS  
Year Ended June 30, 2002

**8. DEFERRED COMPENSATION ARRANGEMENTS:**

On March 31, 1994, DEPCO established an IRA-Simplified Pension Plan (IRA-SEP) for its employees. IRA-SEP is a defined contribution plan. Eligible for IRA-SEP are all employees who have worked at DEPCO for a period of at least six months in the preceding two calendar years, or have performed services during at least three of the preceding five years. Each eligible employee is entitled to select their fiduciary trustee who will be responsible for handling the IRA-SEP. DEPCO's contribution to the IRA-SEP is based on a percentage of each employee's compensation (up to \$150,000 annually), which is voted on by the Board of Directors annually. For the year ended June 30, 2002, DEPCO contributed \$18,934 to the IRA-SEP.

**9. NET ASSETS:**

Net Assets is comprised of the following at June 30, 2002:

|   |                     |
|---|---------------------|
| Cumulative excess of expenses over revenue from<br>Liquidation activities | \$ (289,220,698)    |
| Cumulative net operating transfers from the State                         | <u>297,860,506</u>  |
|   | <u>\$ 8,639,808</u> |

**10. COMMITMENTS AND CONTINGENCIES:**

DEPCO is subject to legal proceedings and claims which have arisen in the ordinary course of its business and have not been finally adjudicated. These actions, when ultimately concluded and determined, will not, in the opinion of management, have a material adverse effect upon the financial position of DEPCO.

DEPCO is obligated by the General Laws (section 42-116-25.1), as described in Note 6- Payments to the State, to pay to the State, upon final defeasance of all corporation bonds, corporation proceeds from all sources on a quarterly basis.

DEPCO is obligated, upon termination of the corporation, to return to the State title to all funds and other properties owned by it as a result of its activities as defined in Chapter 42-116 of the Rhode Island General Laws which remain after provision for the payment or satisfaction of all bonds, and other obligations of the corporation.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

NOTES TO THE FINANCIAL STATEMENTS  
Year Ended June 30, 2002

**11. SETTLEMENTS, NET:**

During the year ended June 30, 2002, DEPCO settled certain suits involving professional malpractice claims and its claims against the Rhode Island Share and Deposit Indemnity Corporation. The settlements, net of attorney fees and costs of \$417,985, totaled \$3,414,822.

RHODE ISLAND DEPOSITORS ECONOMIC PROTECTION CORPORATION  
(A Component Unit of the State of Rhode Island and Providence Plantations)

SUPPLEMENTARY SCHEDULE OF TRAVEL AND ENTERTAINMENT EXPENSES

YEAR ENDED JUNE 30, 2002

| <i>Category:</i>   | <i>Amount</i> |
|--|---------------|
| Mileage reimbursement to DEPCO employees – all individual items less than \$200. | \$ 212        |
| Reimbursement for meals – all individual items less than \$200.                  | <u>27</u>     |
| Total  | <u>\$ 239</u> |



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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:

BOARD OF DIRECTORS OF THE RHODE ISLAND DEPOSITORS ECONOMIC  
PROTECTION CORPORATION:

We have audited the financial statements of the Rhode Island Depositors Economic Protection Corporation (DEPCO), a component unit of the State of Rhode Island, as of and for the year ended June 30, 2002, and have issued our report thereon dated September 26, 2002. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether DEPCO'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 DEPCO'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. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect DEPCO's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Reportable condition

During fiscal 2002, DEPCO continued to downsize its operations and reduce the number of its employees and, accordingly, had limited opportunities to effect segregation of duties relating to accounting and financial reporting.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition described above is not a material weakness.

This report is intended solely for the information and use of the board of directors, 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

September 26, 2002