STATE OF RHODE ISLAND

EMPLOYEES' RETIREMENT SYSTEM

FISCAL YEAR ENDED JUNE 30, 2003

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

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- Reliability
- Independence
- Accountability

July 16, 2004

JOINT COMMITTEE ON LEGISLATIVE SERVICES:

SPEAKER William J. Murphy, Chairman

Senator Joseph A. Montalbano
Senator Dennis L. Algiere
Representative Gordon D. Fox
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, 2003 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

Ernest A. Almonte, CPA, CFE
Auditor General

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
FISCAL YEAR ENDED JUNE 30, 2003

TABLE OF CONTENTS

STATE OF RHODE ISLAND and PROVIDENCE PLANTATIONS
GENERAL ASSEMBLY
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INDEPENDENT AUDITOR'S REPORT

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

RETIREMENT BOARD OF THE EMPLOYEES' RETIREMENT SYSTEM OF
RHODE ISLAND:

We have audited the basic financial statements of the State of Rhode Island and Providence Plantations Employees' Retirement System (the System) as of June 30, 2003 and for the year then ended, as listed in the table of contents. 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 operations 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, 2003, 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 May 14, 2004 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 Management's Discussion and Analysis beginning on page 3 and the Schedules of Funding Progress and the Schedules of Contributions from the Employers and Other Contributing Entity on pages 25 and 26 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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.

Ernest A. Almonte

Ernest A. Almonte, CPA, CFE
Auditor General

May 14, 2004

Management's Discussion and Analysis

Management of the Employees' Retirement System (the System) provides this Management's Discussion and Analysis of their financial performance for the readers of the System's financial statements. This narrative provides an overview of the System's financial activity for the fiscal year ended June 30, 2003. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the System's financial activities based on the status of the System and issues currently facing management.

Understanding the Employees' Retirement System Financial Statements

The Employees' Retirement System administers defined benefit pension plans for state employees, teachers, state police, judges and participating municipal employees. State employees and teachers are combined in one plan while state police, judges and municipal employees are each separate plans. The *Statement of Plan Net Assets* provides a snapshot of the financial position of the System at June 30, 2003. The *Statement of Changes in Plan Net Assets* summarizes the additions and deductions that occurred during the fiscal year. The *Notes to the Financial Statements* provide additional information that is essential to a full understanding of the financial statements. The *Required Supplementary Information* consists of schedules and related notes which demonstrate the System's progress in accumulating funds to meet future pension benefits for members of the System.

Financial Highlights for the Fiscal Year Ended June 30, 2003

- The System's plan net assets decreased by $34 million from $5.5 billion at June 30, 2002. This decrease is primarily attributable to payment of pension benefits that exceeded employer and employee contributions.

- Total pension benefits paid to members were $470.1 million, an increase of $35.6 million or 8.2% compared to the fiscal year ended June 30, 2002.

- Total employee and employer contributions into the System's plans increased $38.7 million compared to the prior year. Total contributions from both employers and employees were $300.5 million.

- The System incurred a net gain from investing activities of $147.2 million for the fiscal year ended June 30, 2003. Included in this amount is $1.8 million in securities lending income.

Management's Discussion and Analysis

Assets, Liabilities and Net Assets
(in millions)

	June 30, 2003	June 30, 2002
Assets:		
Cash and cash equivalents	$ 3.4	$ 4.8
Investments	5,386.7	5,417.6
Contributions receivable	39.3	44.0
Due from other plans	14.7	8.3
Invested securities lending collateral	582.4	527.2
Property and equipment	15.4	12.7
Total assets	6,041.9	6,014.6
Liabilities:		
Accounts payable	4.5	4.8
Due to other plans	14.7	8.3
Securities lending liability	582.4	527.2
Total liabilities	601.6	540.3
Net assets:	$ 5,440.3	$ 5,474.3

Summary of Changes in Plan Net Assets
(in millions)

	Year Ended June 30, 2003	Year Ended June 30, 2002
Additions:		
Contributions	$ 300.5	$ 261.8
Net investment gain (loss)	147.2	(508.9)
Total Additions	447.7	(247.1)
Deductions:		
Benefits	470.1	434.6
Refunds of contributions	6.6	5.7
Administrative expenses	5.0	3.9
Total Deductions	481.7	444.2
Decrease in Plan Net Assets:	$ (34.0)	$ (691.3)
Net Assets:		
Beginning of year	5,474.3	6,165.6
End of year	$ 5,440.3	$ 5,474.3

Management's Discussion and Analysis

Investments

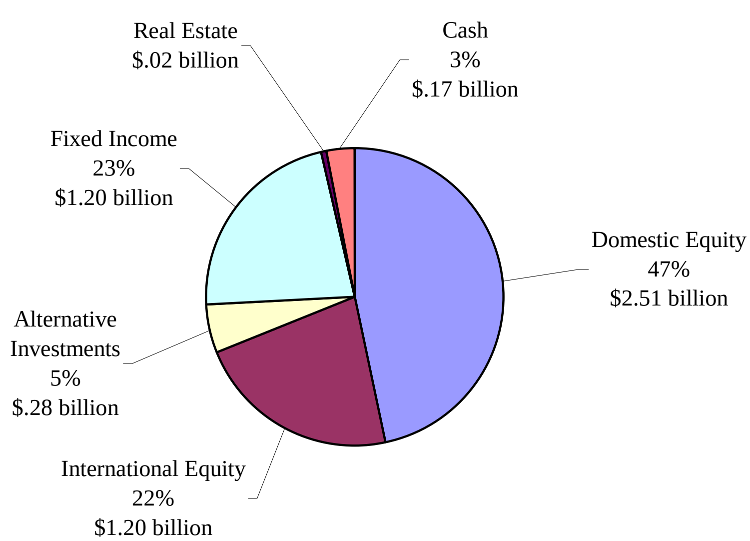
The State Investment Commission (SIC) establishes long-term asset allocation policy and monitors investment performance of the plan. An asset/liability (A/L) study is conducted every two to three years to identify an optimal diversified investment portfolio that maximizes return within an acceptable level of risk. As long-term investors, the SIC is committed to its strategic asset allocation that has been developed as part of a comprehensive A/L study which incorporates capital market return expectations, risks and correlations associated with each asset class as well as the unique profile and objectives of the System. As a defined benefit plan, the System generally has a much longer time horizon than individual investors and is better positioned to withstand short-term volatility of the capital markets.

The following asset allocation targets were in place at June 30, 2003.

Fiscal 2003 – Asset Allocation Targets	
Domestic Equity	42.5%
International Equity	20.0%
Fixed Income	25.0%
Alternative Investments	7.5%
Real Estate*	5.0%

* The real estate allocation was established in January 2003. The majority of this allocation is currently invested in the domestic and international equity portfolios, which will fund approved real estate investments over time.

Asset Allocation - Actual
Fair value (in billions) at June 30, 2003



Management's Discussion and Analysis

The allocation of assets among stocks, bonds and alternative investments can have a significant impact on investment performance. In light of its long time horizon, the SIC is able to take advantage of historical long-term return opportunities offered by equity investments.

Investment Performance

The System's one-year, three-year and five-year time weighted rates of return for the periods ended June 30, 2003 were 3.9%, -5.4% and 0.4%, respectively.

Fiscal year 2003 began with the worst quarter for the US equity markets in over a decade with the S&P 500 losing 17.3% in the quarter ended September 30, 2002. But the year ended on a strong note as investor confidence and technology stocks soared. Both US and non-US equity markets posted double-digit returns with the S&P 500 gaining 15.4% and the Morgan Stanley Capital Investment All Country World Index (MSCI ACWI) returning 19.6% over the quarter ended June 30, 2003. The threat of terrorism was a dominating factor throughout much of the year, which led to significant uncertainty and volatility in the capital markets and a continued flight to quality by investors. Equity market performance was enhanced in the fourth quarter by lower tax rates and strong liquidity along with signs of a tentative US recovery.

For the fiscal year ended June 30, 2003 the domestic equity portfolio was up 2.8% (vs. 0.2% for the S&P 500), the international portfolio was down 7.3% (vs. -4.2% for the MSCI ACWI x US) and the fixed income composite returned 13.0% (vs. 10.4% for the Lehman Aggregate). While the alternative investment portfolio realized a loss of 8.3% on a time-weighted total return basis for fiscal 2003, the private equity composite has generated an internal rate of return of 11.9% since inception and the real estate portfolio has generated a 3.6% return.

The System's actuarial investment return assumption is 8.25%. Actuarial value of assets is determined based on a five-year smoothing methodology.

Funding Status

Independent actuarial valuations are conducted of the System each year. As part of this valuation, the progress toward funding pension obligations of the System is measured by comparing the actuarial value of assets to the actuarial accrued liability. This measure is referred to as the funded ratio or funded status. As reflected in the most recent actuarial valuation (June 30, 2002), the funded ratio decreased to 71.7% for state employees and 73.2% for teachers within the Employees Retirement System plan and decreased for the State Police and Judges plans to 75.5% and 68.5%, respectfully. In total, the Municipal Employees Retirement System Plan decreased its funded ratio but was still overfunded with an overall ratio of 111.3%. Details of the funded status of each plan within the System are included in the Schedules of Funding Progress on page 25.

All employers participating in the System's plans contributed 100% of their annual actuarially required contribution.

Management's Discussion and Analysis

Economic Factors and Next Year's Contribution Rates

The System's investment portfolio experienced positive returns subsequent to June 30, 2003 consistent with the overall performance of domestic and international equity markets.

Employer contribution rates for fiscal 2004 increased for State employees (7.68% for fiscal 2003 compared to 9.60% for fiscal 2004), teachers (11.97% for fiscal 2003 compared to 13.72% for fiscal 2004) and judges (33.42% for fiscal 2003 compared to 33.90% for fiscal 2004). The fiscal 2004 employer contribution rates are based upon an actuarial valuation performed at June 30, 2001.

Contacting the Employees' Retirement System's Management

This discussion and analysis presentation is designed to provide a general overview of the System's financial activity. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Employees' Retirement System, 40 Fountain Street, Providence, RI, 02903.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Statements of Plan Net Assets
As of June 30, 2003

	ERS	MERS	SPRBT	JRBT	Total *Memorandum Only*
Assets					
Cash and cash equivalents (Note 3)	$ 2,597,708	$ 458,808	$ 215,754	$ 154,694	$ 3,426,964
Receivables					
Contributions	19,472,668	1,750,926	-	-	21,223,594
Due from State for teachers	14,872,584	-	-	-	14,872,584
Due from other plans	2,472,280	12,006,320	116,547	80,661	14,675,808
Other	2,945,486	230,709	2,209	6,833	3,185,237
Total receivables	39,763,018	13,987,955	118,756	87,494	53,957,223
Investments at fair value (Note 3)					
Equity in short-term investment fund	-	2,090,765	-	-	2,090,765
Equity in pooled trust	4,639,657,474	693,116,083	17,759,049	11,187,155	5,361,719,761
Plan specific investments	22,850,413	-	-	-	22,850,413
Total investments before lending activities	4,662,507,887	695,206,848	17,759,049	11,187,155	5,386,660,939
Invested securities lending collateral (Note 3)	503,989,579	75,290,685	1,929,027	1,215,174	582,424,465
Property and equipment at cost net of accumulated depreciation (Note 4)					
Line of business system (net of accumulated depreciation $1,358,913)	13,132,723	1,931,230	30,796	19,822	15,114,571
Computer equipment (net of accumulated depreciation $425,559)	263,059	38,405	517	335	302,316
Total property and equipment	13,395,782	1,969,635	31,313	20,157	15,416,887
Total Assets	5,222,253,974	786,913,931	20,053,899	12,664,674	6,041,886,478
Liabilities					
Securities lending liability (Note 3)	503,989,579	75,290,685	1,929,027	1,215,174	582,424,465
Accounts payable	3,808,097	682,293	12,604	8,038	4,511,032
Due to other plans	12,203,528	2,472,280	-	-	14,675,808
Total Liablilities	520,001,204	78,445,258	1,941,631	1,223,212	601,611,305
Net assets held in trust for pension benefits (A schedule of funding progress for each plan is presented on page 25)	$ 4,702,252,770	$ 708,468,674	$ 18,112,268	$ 11,441,463	$ 5,440,275,175

The accompanying notes are an integral part of this financial statement.

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND
Statements of Changes in Plan Net Assets
Fiscal Year ended June 30, 2003

	ERS	MERS	SPRBT	JRBT	Total *Memorandum Only*
Additions					
Contributions					
Member contributions	$ 129,365,297	$ 17,680,088	$ 718,589	$ 433,824	$ 148,197,798
Employer contributions	102,283,913	6,485,065	2,256,770	1,656,965	112,682,713
State contribution for teachers	38,242,690	-	-	-	38,242,690
Interest on service credits purchased	1,254,432	134,524	-	-	1,388,956
Total contributions	271,146,332	24,299,677	2,975,359	2,090,789	300,512,157
Investment income					
Net appreciation in fair value of investments	12,761,770	2,302,774	335,278	199,394	15,599,216
Interest	80,744,407	10,677,586	266,854	167,457	91,856,304
Dividends	38,778,696	5,783,829	135,694	85,222	44,783,441
Other investment income	14,373,078	2,143,693	50,233	31,509	16,598,513
	146,657,951	20,907,882	788,059	483,582	168,837,474
Less investment expense	(20,313,580)	(3,029,465)	(70,915)	(44,239)	(23,458,199)
Net investment income	126,344,371	17,878,417	717,144	439,343	145,379,275
Securities lending					
Securities lending income	6,485,644	968,886	24,824	15,638	7,494,992
Less securities lending expense	(4,943,543)	(738,513)	(18,922)	(11,919)	(5,712,897)
Net securities lending income	1,542,101	230,373	5,902	3,719	1,782,095
Total net investment income	127,886,472	18,108,790	723,046	443,062	147,161,370
Miscellaneous revenue	49,606	4,906	-	-	54,512
Total Additions	399,082,410	42,413,373	3,698,405	2,533,851	447,728,039
Deductions					
Benefits					
Retirement benefits	326,118,741	32,139,989	69,448	118,978	358,447,156
Cost of living adjustments	79,724,969	3,971,476	-	1,382	83,697,827
SRA Plus Option	23,012,613	1,228,457	-	-	24,241,070
Supplemental benefits	1,006,992	-	-	-	1,006,992
Death benefits	2,317,265	425,609	-	-	2,742,874
Total benefits	432,180,580	37,765,531	69,448	120,360	470,135,919
Refund of contributions	5,277,244	1,292,261	-	-	6,569,505
Administrative expense	4,340,497	645,862	11,830	7,640	5,005,829
Total Deductions	441,798,321	39,703,654	81,278	128,000	481,711,253
Net Increase (Decrease)	(42,715,911)	2,709,719	3,617,127	2,405,851	(33,983,214)
Net assets held in trust for pension benefits					
Beginning of year	4,744,968,681	705,758,955	14,495,141	9,035,612	5,474,258,389
End of year	$ 4,702,252,770	$ 708,468,674	$ 18,112,268	$ 11,441,463	$ 5,440,275,175

The accompanying notes are an integral part of this financial statement.

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 (*ERS*)	Cost-sharing multiple-employer defined benefit plan
Municipal Employees' Retirement System (*MERS*)	Agent multiple-employer defined benefit plan
State Police Retirement Benefits Trust (*SPRBT*)	Single-employer defined benefit plan
Judicial Retirement Benefits Trust (*JRBT*)	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 Fiduciary 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.

1. Plan Descriptions (continued)

(a). General

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, 2002 actuarial valuation is listed below:

	Retirees and beneficiaries	*Terminated plan members entitled to but not yet receiving benefits*	*Active Vested*	*Active Non-vested*	*Total by Plan*
ERS					
State Employees	9,426	1,569	8,906	4,889	24,790
Teachers	7,311	1,042	7,568	7,142	23,063
MERS					
General Employees	3,336	1,103	2,768	4,245	11,452
Public Safety	317	33	561	552	1,463
SPRBT	1	-	-	150	151
JRBT	1	-	-	39	40
Total by type	20,392	3,747	19,803	17,017	60,959

(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

1. Plan Descriptions (continued)

(b). Membership and Benefit Provisions

Development Corporation (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.

1. Plan Descriptions (continued)

(b). Membership and Benefit Provisions

Spouse, parents, family and children's benefits are payable following the death 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:

Highest Annual Salary	Spousal Monthly Minimum Benefit
$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.

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

1. Plan Descriptions (continued)

(b). Membership and Benefit Provisions

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	65
Municipal police and fire departments	44
Total participating units as of the actuarial valuation at June 30, 2002	109

(3) State Police Retirement Benefits Trust (SPRBT)

The State Police Retirement Benefits Trust was established under Rhode Island General Law Section 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 earned at retirement including longevity increment, holiday pay, clothing allowance and up to 400 overtime hours.

1. Plan Descriptions (continued)

(b). Membership and Benefit Provisions

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 accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Governmental Accounting Standards Board (GASB) is responsible 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 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.

2. Summary of Significant Accounting Policies (continued)

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. Commingled funds consist primarily of institutional equity index funds. The fair value of the commingled funds is 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 and computer equipment recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives, ten and five years respectfully. Depreciation of the Line of Business System commences as each stage is implemented. Stage 1 was implemented on December 1, 2001. Property, plant and equipment is allocated to each plan based on its proportionate share of net assets.

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. Inter-fund 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, 2003, the carrying amounts of the plans' cash deposits are listed below:

	ERS	MERS	SPRBT	JRBT
Book balance	$ 2,392,125	$ 93,484	$ 2,246	$ 1,549
Bank balance	$ 1,803,591	$ 79,135	$ 213,328	$ 153,146

The bank balances represent the plans' deposits in short-term trust accounts that are covered by federal depository insurance. The book and bank balances include a certificate of deposit of $1.5 million in ERS with a maturity of less than sixty days. 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 Law 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, 2003.

3. Cash Deposits and Investments (continued)

(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 Law Section 35-10-11 (b)(3) requires that all investments shall be made in securities as would be 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, 2003, the ERS held a loan receivable with a fair value of $22,350,413. 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, 2003:

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.

3. Cash Deposits and Investments (continued)

(b). Investments

Investments - Category 1	*Short-term Investment Fund*	*Pooled Trust*	*Plan Specific*
US Government and Agency Securities			
Not on securities loan		$ 318,158,662	
On loan for securities collateral		2,432,855	
Domestic Corporate Bonds and Notes		693,178,513	$ 22,350,413
Foreign Bonds		2,742,370	
Domestic Equity Securities			
Not on securities loan		958,186,513	
On loan for securities collateral		35,472	
Foreign Equity Securities			
Not on securities loan		873,146,663	
On loan for securities collateral		1,006,698	
Repurchase Agreements		937,560	
Subtotal	-	2,849,825,306	22,350,413
Items not categorized			
Commingled funds		1,478,640,837	
Real Estate and Alternative Investment Partnerships		310,924,134	
Money Market Mutual Funds	$ 2,070,102	169,779,259	500,000
Investments held by broker-dealers under securities loans with cash collateral			
US Government and Agency Securities		106,815,621	
Domestic Corporate Bonds and Notes		60,223,990	
Domestic Equity Securities		192,452,253	
Foreign Equity Securities		202,598,824	
Securities lending short-term collateral investment pool		582,424,465	
Subtotal	2,070,102	3,103,859,383	500,000
Total	2,070,102	5,953,684,689	22,850,413
Reconciliation to Statements of PlanNet Assets			
Total above	2,070,102	5,953,684,689	22,850,413
Net investment payable/receivable	20,663	(22,075,094)	
Foreign cash *		5,538,864	
Domestic cash *		7,933,327	
Securities Lending short-term collateral investment pool		(582,424,465)	
Cash equivalents		(937,560)	
Investments on Statements of Plan Net Assets	$ 2,090,765	$ 5,361,719,761	$ 22,850,413

* Foreign cash deposits at the System's custodian bank are uncollateralized and are not covered by United States federal depository insurance. Domestic cash deposits are fully insured by the Federal Deposit Insurance Corporation.

3. Cash Deposits and Investments (continued)

(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. According to investment policy guidelines derivative type instruments may be used for hedging purposes and not for leveraging plan assets. Through commingled funds, the System also indirectly holds derivative type instruments, primarily equity index futures.

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 tends to increase the System's exposure to the underlying instrument. Selling futures tends 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

3. Cash Deposits and Investments (continued)

(c). Derivatives and Other Similar Investments

sensitive to interest rate fluctuations. 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 commingled funds 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 commingled fund when the price of a security underlying the short sale increases and the commingled fund 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. 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 64 days and a weighted average maturity of 252 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, 2003, management believes the System has no credit risk exposure to borrowers because the amounts the System owes the borrowers do not exceed the amounts the borrowers owe the System. The securities on loan at year-end were $565,565,715 (fair value), and the collateral received for those securities on loan was $586,117,017 (fair value).

4. Property, Plant and Equipment

Property, plant and equipment consist of the line of business system and computer equipment at historical cost. Balances at June 30, 2003 were:

	ERS	MERS	SPRBT	JRBT	Total
Line of Business System	$14,315,084	$2,103,863	$ 33,177	$ 21,360	$16,473,484
Accumulated Depreciation	1,182,361	172,633	2,381	1,538	1,358,913
Net Line of Business System	$13,132,723	$1,931,230	$ 30,796	$ 19,822	$15,114,571
Equipment	$ 633,385	$ 92,454	$ 1,235	$ 801	$ 727,875
Accumulated Depreciation	370,326	54,049	718	466	425,559
Net Equipment	$ 263,059	$ 38,405	$ 517	$ 335	$ 302,316

5. 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

The funding policies, as set forth in Rhode Island General Law, Section 36-10-2 and 45-21-42 provide for actuarially determined periodic contributions to the plans. The actuarial valuation uses the Entry Age Normal actuarial cost method. Under this method, the employer contribution rate is the sum of (i) the employer normal cost rate, and (ii) a rate that will amortize the unfunded actuarial liability. The valuation is prepared on the projected benefit basis, under which the present value, at the assumed rate of return (currently 8.25 percent), of each participant's expected benefit payable at retirement or death is determined, based on age, service, gender and compensation.

The employer contributions required to support the benefits of the Plan are determined following a level funding approach, and consist of a normal contribution and an accrued liability contribution. The normal contribution is determined using the "entry age normal" method. Under this method, a calculation is made to determine the average uniform and constant percentage rate of employer contribution which, if applied to the compensation of each new participant during the entire period of his anticipated covered service, would be required in addition to the contributions of the participant to meet the cost of all benefits payable on his behalf. The unfunded accrued liability contributions are determined by subtracting the actuarial value of

5. Contributions and Reserves (continued)

(a). Funding Policy

assets from the actuarial accrued liability and amortizing the result over a period not to exceed 30 years from June 30, 1999.

(b). Contributions

Employer contribution rates for fiscal 2003 were developed based on an actuarial valuation performed as of June 30, 2000. The table below displays the contribution rates for the year ending June 30, 2003:

Plan	Employee	Employer
ERS		
State Employees	8.75%	7.68%
Teachers	9.50%	
Municipal funded		6.93% (6.31*% for towns not participating in the 1990 early retirement incentive*)
State funded		5.04% (4.63*% for towns not participating in the 1990 early retirement incentive*)
MERS		
General Employees	6.00% (additional 1% with a cost-of-living adjustment)	65 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), Cranston Police and Cranston Fire are contributing 10% due to special plan provisions	44 Municipal police and fire departments contributed various actuarially determined rates.
SPRBT	8.75%	27.48%
JRBT	8.75%	33.42%

6. Administrative Expenses

Pursuant to General Law section 36-8-10.1, administrative costs of the System are financed through investment earnings up to a maximum of .175% of the average total investments before lending activities as reported in the annual report of the Auditor General for the next preceding five (5) fiscal years. Such amounts are transferred to a restricted receipt account within the State's general fund. Any unencumbered funds on June 30 of any fiscal year shall be credited to the plans in the same proportion as their contributions to the restricted receipt account.

7. Post-Employment Health Care Benefits

In accordance with the General Laws, post-employment health care benefits are provided to State employee members of the ERS plan who retire on or after July 1, 1989. The benefits in general cover medical and hospitalization costs for pre-Medicare retirees and a Medicare supplement for Medicare eligible retirees. The State's share of the costs of these benefits ranges from 50% for retirees with 10-15 years of service to 100% for retirees with 35 years of service. These benefits are provided on a pay-as-you-go basis and are not accounted for as part of the Employees' Retirement System. The financial activity related to post-employment benefits for state employees is reflected in the State's general fund.

8. 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 $17.8 million, of which $17.2 million has been recorded as Property and Equipment. The remaining cost is estimated at $.6 million. This will be financed in the same manner as other administrative expenses of the System. Full implementation is expected by the fourth quarter of fiscal 2004.

Employees' Retirement System of Rhode Island

Required Supplementary Information

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

REQUIRED SUPPLEMENTARY INFORMATION

Schedules Of Funding Progress

Actuarial Valuation Date		Actuarial Value of Assets (a)	** Actuarial Accrued Liability (AAL) - Entry Age - (b)	*** Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
ERS (*State Employees*)							
6/30/2002		$ 2,353,855,871	$ 3,284,126,961	$ 930,271,090	71.7%	$ 586,888,754	158.5%
6/30/2001		2,406,278,029	3,089,247,738	682,969,709	77.9%	539,015,218	126.7%
6/30/2000		2,345,319,663	2,874,905,547	529,585,884	81.6%	517,632,152	102.3%
6/30/1999	*	2,201,890,748	2,607,397,329	405,506,581	84.4%	494,815,513	82.0%
6/30/1998		2,075,619,320	2,576,282,134	500,662,814	80.6%	477,319,627	104.9%
6/30/1997		1,810,447,649	2,312,563,765	502,116,116	78.3%	443,709,290	113.2%
ERS (*Teachers*)							
6/30/2002		$ 3,553,823,995	$ 4,857,003,061	$ 1,303,179,066	73.2%	$ 792,015,577	164.5%
6/30/2001		3,619,863,426	4,679,288,010	1,059,424,584	77.4%	748,460,527	141.5%
6/30/2000		3,514,399,312	4,359,881,262	845,481,950	80.6%	703,201,056	120.2%
6/30/1999	*	3,259,015,814	3,967,529,172	708,513,358	82.1%	673,484,467	105.2%
6/30/1998		3,045,858,851	3,999,722,806	953,863,955	76.2%	636,246,593	149.9%
6/30/1997		2,626,621,502	3,579,652,537	953,031,035	73.4%	604,076,573	157.8%
SPRBT							
6/30/2002		$ 17,770,149	$ 23,527,125	$ 5,756,976	75.5%	$ 10,933,360	52.7%
6/30/2001		14,386,064	16,649,820	2,263,756	86.4%	9,139,418	24.8%
6/30/2000		11,336,596	13,917,343	2,580,747	81.5%	8,916,914	28.9%
6/30/1999	*	8,480,657	10,841,544	2,360,887	78.2%	7,502,433	31.5%
6/30/1998		6,756,892	7,338,161	581,269	92.1%	7,211,874	8.1%
6/30/1997		4,861,569	5,435,913	574,344	89.4%	5,370,985	10.7%
JRBT							
6/30/2002		$ 11,129,208	$ 16,243,709	$ 5,114,501	68.5%	$ 4,738,059	107.9%
6/30/2001		9,190,325	12,026,257	2,835,932	76.4%	4,092,423	69.3%
6/30/2000		7,374,851	9,719,608	2,344,757	75.9%	3,533,354	66.4%
6/30/1999	*	5,521,693	7,415,237	1,893,544	74.5%	3,169,183	59.7%
6/30/1998		4,120,032	5,048,855	928,823	81.6%	3,039,957	30.6%
6/30/1997		2,607,482	3,508,327	900,845	74.3%	2,815,218	32.0%
MERS							
6/30/2002		$ 907,193,399	$ 814,857,497	$ (92,335,902)	111.3%	$ 247,613,063	(37.3)%
6/30/2001		895,475,425	758,089,758	(137,385,667)	118.1%	225,827,136	(60.8)%
6/30/2000		885,392,216	710,616,311	(174,775,905)	124.6%	207,834,738	(84.1)%
6/30/1999		805,493,262	635,863,479	(169,629,783)	126.7%	191,234,546	(88.7)%
6/30/1998		737,745,574	572,905,862	(164,839,712)	128.8%	181,260,006	(90.9)%
6/30/1997		667,632,428	502,247,591	(165,384,837)	132.9%	167,527,881	(98.7)%

See notes to required supplementary information

***** Restated numbers based on Entry Age Normal funding method

****** Frozen Actuarial Liability for ERS, SPRBT, JRBT for plan years 1998 and prior

******* Unfunded Frozen Actuarial Liability for ERS, SPRBT, JRBT for plan years 1998 and prior

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND

REQUIRED SUPPLEMENTARY INFORMATION

Schedules Of Contributions From The Employers

And Other Contributing Entity

ERS

Fiscal Year Ended June 30	State Employees		Teachers (State)		Teachers (Employers)	
	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
2003	$ 45,323,258	100%	$ 38,242,690	100%	$ 56,888,431	100%
2002	31,801,645	100%	30,763,337	100%	44,391,050	100%
2001	44,540,998	100%	35,365,234	100%	48,153,386	100%
2000	44,353,675	100%	40,719,407	100%	57,667,528	100%
1999	48,526,064	100%	30,202,943	100%	42,373,952	100%
1998	51,310,092	100%	35,005,382	100%	52,040,574	100%

MERS

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
2003	6,485,065	100%
2002	7,536,081	100%
2001	6,092,688	100%
2000	5,823,861	100%
1999	6,608,642	100%
1998	5,139,666	100%

SPRBT

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
2003	2,256,770	100%
2002	2,405,041	100%
2001	1,819,930	100%
2000	1,508,778	100%
1999	631,386	100%
1998	602,630	100%

JRBT

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
2003	1,656,965	100%
2002	1,458,093	100%
2001	1,163,571	100%
2000	1,007,618	100%
1999	737,414	100%
1998	744,054	100%

1. Schedules of Funding Progress

Effective with the June 30, 2002 valuation, the amortization period for the unfunded actuarial accrued liability for MERS was changed to 30 years from June 30, 1999 or 27 years from June 30, 2002.

Effective with the June 30, 2002 valuation, the actuarial value of assets for MERS was changed from a three-year smoothed market technique to a five-year smoothed market technique.

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 smoothing of the 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%.

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 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 contribution.

2. Schedules of Employer Contributions (continued)

The Plans used the entry age normal cost method as the basis for determining employer costs in fiscal year 2002. The unfunded liabilities of the plans are amortized over a 30 year period from June 30, 1999. The closed period ends 30 years from June 30, 1999.

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				
	State Employees	***Teachers***	**MERS**	**SPRBT**	**JRBT**
Valuation Date	6/30/02	6/30/02	6/30/02	6/30/02	6/30/02
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	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed	Level Percent of Payroll – Closed
Equivalent Single Remaining Amortization Period	27 years	27 years	27 Years	27 years	27 years
Asset Valuation Method	5 Year Smoothed Market	5 Year Smoothed Market	5 Year Smoothed Market	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%	*General Employees* 4.25% to 10.25% *Police & Fire Employees* 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 Note1(b)(4)*) to the financial statements

STATE OF RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

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- 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:

RETIREMENT BOARD OF THE EMPLOYEES' RETIREMENT SYSTEM OF
RHODE ISLAND:

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, 2003 and the related statements of changes in plan net assets for the year then ended, and have issued our report thereon dated May 14, 2004. 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. 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 the System's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Reportable Condition

The following issues related to implementation of a new member and financial reporting database during fiscal 2002 continued to impact the quality and reliability of contributions and contributions receivable reported by the accounting system as follows:

- The accounting system did not adequately track and report delinquent contributions during the fiscal year.
- Offline manual records were maintained to supplement system generated data for contributions and contributions receivable when data entry errors occurred resulting in incorrect cash postings to employer accounts.
- Controls to ensure the detail contribution database is reconciled to the financial reporting system were not operational during the fiscal year. This feature was programmed as part of the new system but was not operational throughout the fiscal year.

The System has implemented both procedural and system enhancements during fiscal 2004 which will enhance control over financial reporting of contributions and contributions receivable.

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 consider the reportable condition described above to be a material weakness.

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

Ernest A. Almonte, CPA, CFE
Auditor General

May 14, 2004