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STATE OF RHODE ISLAND

EMPLOYEES' RETIREMENT SYSTEM

FISCAL YEAR ENDED JUNE 30, 1997

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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

ERNEST A. ALMONTE, CPA, CFE  
Auditor General

GENERAL ASSEMBLY  
**Office of the Auditor General**

1145 Main Street  
Pawtucket, Rhode Island 02860-4807

OFFICE  
(401) 277-2435  
FAX  
(401) 277-2111

April 8, 1998

JOINT COMMITTEE ON LEGISLATIVE SERVICES:

SPEAKER John B. Harwood, Chairman

Senator Paul S. Kelly  
Senator Dennis L. Algieri  
Representative George D. Caruolo  
Representative Wayne L. Salisbury

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, 1997 in accordance with Rhode Island General Laws, Chapters 22-13 and 35-7.

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

Sincerely,

Ernest A. Almonte, CPA, CFE  
Auditor General

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
FOR THE FISCAL YEAR ENDED JUNE 30, 1997**

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State of Rhode Island and Providence Plantations

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**INDEPENDENT AUDITOR'S REPORT**

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

We have audited the accompanying statements of plan net assets of the State of Rhode Island and Providence Plantations Employees' Retirement System (the System) as of June 30, 1997 and the related statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

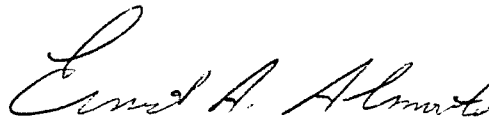
As discussed in Note 1(a), the financial statements referred to above present only the plan net assets and changes in plan net assets of the Pension Trust Funds of the State of Rhode Island and Providence Plantations (the State) and are not intended to present fairly the financial position and results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

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, 1997, and the changes in plan net assets for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 6 to the financial statements, the System implemented Governmental Accounting Standards Board Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans" and Statement No. 26, "Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans".

In accordance with *Government Auditing Standards*, we have also issued a report dated February 13, 1998 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.

The Schedules of Funding Progress and the Schedules of Contributions from the Employers and Other Contributing Entity on pages 18 and 19 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



Ernest A. Almonte, CPA, CFE  
Auditor General

February 13, 1998

**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**

*Statements of Plan Net Assets*

*June 30, 1997*

	<u>ERS</u>	<u>MERS</u>	<u>SPRBT</u>	<u>JRBT</u>	<u>PHF</u>	<i>Total (Memorandum Only)</i>
<b>Assets</b>						
Cash and cash equivalents <i>(Note 3)</i>	\$ 3,619,352	\$ 271,741	\$ 114,352	\$ 103,102	\$ 292,367	\$ 4,400,914
Receivables						
Member contributions	10,910,674	1,588,933	-	-	-	12,499,607
Employer contributions	12,497,458	818,395	-	-	239,586	13,555,439
Due from state for teachers	10,537,737	-	-	-	-	10,537,737
Interest and dividends	467	15	-	-	-	482
Total receivables	<u>33,946,336</u>	<u>2,407,343</u>	<u>-</u>	<u>-</u>	<u>239,586</u>	<u>36,593,265</u>
Investments, at fair value <i>(Note 3)</i>						
Equity in Short-Term Investment Fund	2,718,705	4,976,910	-	-	-	7,695,615
Equity in Pooled Trust	4,519,456,878	660,416,029	4,750,281	2,505,989	-	5,187,129,177
Plan specific investments	<u>27,898,511</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>27,898,511</u>
Total investments	<u>4,550,074,094</u>	<u>665,392,939</u>	<u>4,750,281</u>	<u>2,505,989</u>	<u>-</u>	<u>5,222,723,303</u>
Total assets	4,587,639,782	668,072,023	4,864,633	2,609,091	531,953	5,263,717,482
<b>Liabilities</b>						
Accounts and vouchers payable	2,995,157	439,595	3,064	1,609	487,696	3,927,121
Payable to certain individuals <i>(Note 5)</i>	<u>1,005,488</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,005,488</u>
Total liabilities	<u>4,000,645</u>	<u>439,595</u>	<u>3,064</u>	<u>1,609</u>	<u>487,696</u>	<u>4,932,609</u>
Net assets held in trust for pension and postemployment healthcare benefits (A schedule of funding progress for each plan is presented on page 18.)	<u>\$ 4,583,639,137</u>	<u>\$ 667,632,428</u>	<u>\$ 4,861,569</u>	<u>\$ 2,607,482</u>	<u>\$ 44,257</u>	<u>\$ 5,258,784,873</u>

*See notes to financial statements.*

**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**

**Statements of Changes In Plan Net Assets  
Fiscal Year Ended June 30, 1997**

	<u>ERS</u>	<u>MERS</u>	<u>SPRBT</u>	<u>JRBT</u>	<u>PHF</u>	<i>Total (Memorandum Only)</i>
<b>Additions</b>						
Contributions						
Member/retiree contributions	\$ 96,933,887	\$ 12,809,252	\$ 337,364	\$ 243,513	\$ 1,917,530	\$ 112,241,546
Employer contributions	95,838,376	8,734,795	453,621	618,513	2,979,338	108,624,643
State contributions for teachers	34,521,868	-	-	-	-	34,521,868
Interest on service credits purchased	646,821	122,635	-	-	-	769,456
Service credit transfer payments	<u>117,586</u>	<u>28,529</u>	-	-	-	<u>146,115</u>
Total contributions	<u>228,058,538</u>	<u>21,695,211</u>	<u>790,985</u>	<u>862,026</u>	<u>4,896,868</u>	<u>256,303,628</u>
Investment income						
Net appreciation in fair value of investments	578,932,867	84,816,904	580,682	288,708	-	664,619,161
Interest	108,502,125	15,849,777	101,813	48,358	3,434	124,505,507
Dividends	39,887,335	5,857,352	38,856	18,643	-	45,802,186
Other investment income	<u>24,980,434</u>	<u>3,667,297</u>	<u>24,312</u>	<u>11,663</u>	-	<u>28,683,706</u>
	752,302,761	110,191,330	745,663	367,372	3,434	863,610,560
Less investment expense	<u>13,120,387</u>	<u>1,924,031</u>	<u>12,648</u>	<u>6,254</u>	-	<u>15,063,320</u>
Net investment income	<u>739,182,374</u>	<u>108,267,299</u>	<u>733,015</u>	<u>361,118</u>	<u>3,434</u>	<u>848,547,240</u>
Total additions	<u>967,240,912</u>	<u>129,962,510</u>	<u>1,524,000</u>	<u>1,223,144</u>	<u>4,900,302</u>	<u>1,104,850,868</u>
<b>Deductions</b>						
Benefits						
Retirement benefits	198,273,228	21,254,310	-	-	-	219,527,538
Cost of living adjustment	44,268,756	1,421,422	-	-	-	45,690,178
SRA Plus (option)	11,096,199	1,030,698	-	-	-	12,126,897
Supplemental benefits	742,129	-	-	-	-	742,129
Death benefits post retirement	2,241,222	726,396	-	-	-	2,967,618
Death benefits pre retirement	<u>508,800</u>	<u>88,000</u>	-	-	-	<u>596,800</u>
Total benefits	257,130,334	24,520,826	-	-	-	281,651,160
Healthcare premiums	-	-	-	-	5,169,951	5,169,951
Refund of contributions	5,412,940	1,050,035	1,685	-	3,136	6,467,796
Administrative expense	1,988,805	285,805	634	180	-	2,275,424
Service credit transfer payments	<u>28,529</u>	<u>117,586</u>	-	-	-	<u>146,115</u>
Total deductions	<u>264,560,608</u>	<u>25,974,252</u>	<u>2,319</u>	<u>180</u>	<u>5,173,087</u>	<u>295,710,446</u>
Net increase/(decrease)	702,680,304	103,988,258	1,521,681	1,222,964	(272,785)	809,140,422
Net assets held in trust for pension and postemployment healthcare benefits						
Beginning of year, as restated (Note 6)	<u>3,880,958,833</u>	<u>563,644,170</u>	<u>3,339,888</u>	<u>1,384,518</u>	<u>317,042</u>	<u>4,449,644,451</u>
End of year	<u>\$4,583,639,137</u>	<u>\$ 667,632,428</u>	<u>\$ 4,861,569</u>	<u>\$ 2,607,482</u>	<u>\$ 44,257</u>	<u>\$ 5,258,784,873</u>

See notes to financial statements.

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Financial Statements***

**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:

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

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

Healthcare benefits are provided to certain state retirees under the Postemployment Healthcare Fund (PHF), a single employer defined benefit postemployment healthcare plan.

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

The System is administered by the State of Rhode Island Retirement Board which consists of 15 members: the general treasurer; the director of administration or his or her designee; the budget officer or his or her designee; the fiscal advisor to the house finance committee or his or her designee; the president of the league of cities and towns or his or her designee; two (2) active State employee members of the retirement system or officials from state employee unions to be elected by active State employees; two (2) active teacher members of the retirement system or officials from a teachers union to be elected by active teachers; one active municipal employee member of the retirement system or an official from a municipal employees union to be elected by active municipal employees; one retired member of the retirement system to be elected by retired members of the System; the



**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**  
**Notes to Financial Statements**

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.

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, 1996 actuarial valuation is listed below:

	<i>Retirees and beneficiaries</i>	<i>Terminated plan members entitled to but not yet receiving benefits</i>	<i>Active Vested</i>	<i>Active Non- vested</i>	<i>Inactive</i>	<i>Total by Plan</i>
<b><u>ERS</u></b>						
State Employees	8,617	762	7,586	5,390	1,565	23,920
Teachers	5,229	370	7,251	5,140	803	18,793
<b><u>MERS</u></b>						
General Employees	2,819	293	2,206	3,539	655	9,512
Public Safety	194	-	354	444	28	1,020
<b><u>SPRBT</u></b>	-	-	-	97	-	97
<b><u>JRBT</u></b>	-	-	-	27	-	27
<i>Total by type</i>	16,859	1,425	17,397	14,637	3,051	53,369

**(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.

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Financial Statements***

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

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 non-service-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

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Financial Statements***

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.

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

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

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

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

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

(2) Municipal Employees' Retirement System (MERS)

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

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Financial Statements***

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

The plan also provides non-service-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.	59
Municipal police and fire departments.	<u>36</u>
Total participating units as of June 30, 1997	95

(3) State Police Retirement Benefits Trust (SPRBT)

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

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

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

**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**  
**Notes to Financial Statements**

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

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

**(4) Judicial Retirement Benefits Trust (JRBT)**

The Judicial Retirement Benefits Trust was established under Rhode Island General Laws 8-3-16; 8-8-10.1; 28-30-18.1; 31-43-11.1; and was placed under the management of the Retirement Board for the purpose of providing retirement allowances to Justices of the Supreme, Superior, Family, District, Workers Compensation and Administrative Adjudication 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. Administrative Adjudication 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.

**(5) Postemployment Healthcare Fund (PHF)**

In accordance with the Rhode Island General Laws 36-12-4, postemployment healthcare benefits are also provided to all State employees who retire on or after July 1, 1989. The benefits in general cover medical and hospitalization costs for pre-Medicare-eligible retirees and a Medicare supplement for Medicare-eligible retirees. The State is required to pay a portion of the monthly premium. This payment varies with years of service and ranges from 50% for retirees with 10-15 years of service to 100% for retirees with 35 years of service.

Retirees receiving postemployment healthcare plan benefits, as of June 30, 1997, is as follows:

Pre- age 65	717
Age 65 and older	<u>1,386</u>
	2,103

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Financial Statements***

**2. Summary of Significant Accounting Policies**

These financial statements were prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB).

**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. 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. The Governmental Accounting Standards Board (GASB) has the responsibility for establishing generally accepted accounting principles for fiduciary 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.

**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 which are not traded on a national security exchange are valued by the respective fund manager. Short-term investments are stated at cost which approximates fair value. Investment transactions are recorded on a trade date basis.

**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.

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Financial Statements***

**Foreign Currency Exchange Contracts** - The System may enter into foreign currency exchange contracts to minimize the short-term impact of foreign currency fluctuations on the asset and liability positions of foreign investments. The gains or losses on these 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.

**Mortgage-Backed Securities** - The System invests in various mortgage-backed securities, such as collateralized mortgage obligations, interest-only strips, and principal-only strips. They are reported in aggregate as U.S. Government and Agency Securities in the disclosure of custodial credit risk (See Note 3 on Investments). 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. The System held no interest-only strips and principal-only strips at June 30, 1997.

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

### **3. Cash Deposits and Investments**

#### **(a). Cash Deposits and Cash Equivalents**

At June 30, 1997, the carrying amounts of the plans' cash deposits are listed below:

	<u>ERS</u>	<u>MERS</u>	<u>SPRBT</u>	<u>JRBT</u>	<u>PHF</u>	<u>Total</u>
Book Balance	\$533,302	\$172,191	\$114,352	\$103,102	\$292,367	\$1,215,314
Bank Balance	\$993,867	\$114,333	\$113,374	\$102,627	\$57,620	\$1,381,821

The bank balances represent the plans' deposits in short-term trust accounts which are covered by federal depository insurance.

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Financial Statements***

Cash equivalents consist of \$3,185,600 in U.S. Government Agency Securities held by ERS (\$3,086,050) and MERS (\$99,550). These are category 1 type investments (See Note 3 (b). Investments).

In accordance with Rhode Island General Laws, Chapter 35-10.1, depository institutions holding deposits of the State, its agencies or governmental subdivisions of the State, shall at a minimum, insure or pledge eligible collateral equal to one hundred percent of time deposits with maturities greater than sixty days. Any of these institutions that do not meet minimum capital standards prescribed by federal regulators shall insure or pledge eligible collateral equal to one hundred percent of deposits, regardless of maturity. None of the System's deposits was required to be collateralized at June 30, 1997.

**(b). Investments**

The State Investment Commission oversees all investments made by the State of Rhode Island, including those made for the System. Certain investments are made by investment managers, engaged by the Commission, at their discretion in accordance with the investment objectives and guidelines for the System. Certain short-term investments are made on a daily basis by the General Treasurer. Rhode Island General Laws, 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 plan's 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, 1997, the ERS held investments in bonds issued by the R.I. Housing and Mortgage Finance Corporation having a fair value of \$3,912,912 and the R.I. Industrial Facilities Corporation having a fair value of \$23,000,000. These entities are included as discretely presented proprietary component units in the State of Rhode Island Comprehensive Annual Financial Report.

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, 1997:



**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**  
**Notes to Financial Statements**

**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.

	<u>Short-term</u> <u>Investment Fund</u>	<u>Pooled</u> <u>Trust</u>	<u>Plan</u> <u>Specific</u>
<u>Investments - Category 1</u>			
U.S. Government and Agency Securities	\$ -	\$1,290,772,469	\$ -
Corporate Bonds and Notes		232,837,957	26,912,912
Foreign Bonds		52,613,198	
Equity Securities		2,506,723,233	
Foreign Equity Securities	-	649,479,845	-
Subtotal	-	4,732,426,702	26,912,912
<u>Investments not categorized</u>			
Real Estate and Venture Capital Limited Partnerships		157,011,140	
Emerging Markets Equity Mutual Fund		106,685,837	
Money Market Mutual Funds	7,637,482	180,569,715	246,064
Subtotal	7,637,482	444,266,692	246,064
Total	\$ 7,637,482	\$5,176,693,394	\$ 27,158,976
<u>Reconciliation to investments on Statements of Plan</u>			
<u>Net Assets</u>			
Total above	7,637,482	5,176,693,394	27,158,976
Net investment payable and receivable	58,133	4,631,787	739,535
Foreign Cash *		5,271,827	
Domestic Cash *	-	532,169	-
Investments on Statements of Plan Net Assets	\$ 7,695,615	\$5,187,129,177	\$ 27,898,511

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

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Financial Statements***

**(c). Forward Foreign Currency Contracts**

The System may enter into forward foreign currency contracts. 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 (U.S. 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.

**4. Contributions and Reserves**

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

**(a). Funding Policy**

ERS, SPRBT and JRBT

The funding policy, as set forth in Rhode Island General Laws, Section 36-10-2 provides for actuarially determined periodic contributions to the plans. The Employer's contributions to the plans include: (1) normal cost; (2) a payment required to amortize the unfunded frozen actuarial liability over twenty-seven years, beginning as of July 1, 1989, calculated such that each year's total unfunded liability payment increases at the assumed rate of inflation over the prior year's total payment; provided any subsequent changes to the unfunded liability due to changes to benefits or actuarial assumptions are amortized over a new 30-year period or over the remaining initial amortization period depending on how large the total change to the unfunded liability for each fiscal year is relative to the existing unfunded liability; and (3) interest on the unfunded frozen actuarial liability. The normal cost is determined using the entry age normal cost method with frozen initial liability.

MERS

The funding policy, as set forth in Rhode Island General Laws, Section 45-21-42 provides for actuarially determined periodic contributions to the plans. Each employer's contribution to the plans includes normal cost and a payment, where applicable, to amortize the unfunded actuarial liability. The normal cost is determined using the entry age normal cost method. In 1989, the rules regarding the amortizing of the unfunded liability were changed. The new rules provided that

**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**  
**Notes to Financial Statements**

the unfunded liability in 1988 will be amortized over the remainder of a 25-year period which commenced on the date the unit joined the plan. Subsequent divergences from the actuarial assumptions are funded over the projected future salaries of active members. Due to large fluctuations in the contribution rates of certain municipalities, the Retirement Board adopted a procedure which allows an employer the option of paying a contribution rate equal to the previous year's rate plus the greater of 2 percent or one eighth of the increase in the contribution rate, plus the cost of any benefit improvements.

**PHF**

The contribution rates to the plan are not actuarially determined. The State's contribution for postemployment healthcare benefits for the fiscal year ending June 30, 1997 was 0.66% of active covered payroll.

**Administrative Expenses**

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

**(b). Contributions**

The table below displays the contribution rates for the period ending June 30, 1997:

Plan	Employee	Employer
<b>ERS</b>		
State Employees	8.75%	10.05%
Teachers	9.50%	8.25% (7.21% for towns not participating in the 1990 early retirement incentive)
<i>Municipal funded</i>		
<i>State funded</i>		6.00% (5.31% for towns not participating in the 1990 early retirement incentive)
<b>MERS</b>		
General Employees	6.00% to 7.00% with a cost-of-living adjustment	59 Municipalities, housing authorities, water and sewer districts contributed various actuarially determined rates.
Public Safety	7.00% to 9.00% ( 1% with a cost-of-living adjustment and /or 1% with a 20 year service plan)	36 Municipal police and fire departments contributed various actuarially determined rates.
<b>SPRBT</b>	8.75%	12.46%
<b>JRBT</b>	8.75%	23.65%

**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**  
**Notes to Financial Statements**

**5. Payable To Certain Individuals**

The ERS is involved in litigation by certain individuals who are contesting the constitutionality of Section 36-9.1-2 which repealed Section 36-9-33 of the General Laws thereby depriving those individuals of the right to participate in the plan. Pursuant to the statute, the plan was required by January 1, 1995, to return to the employees their contribution with interest at the rate of 8% for the applicable time periods during which the contributions were held by the plan. By agreement between the parties, the plan will continue to hold the employee contributions in the amount of \$1,005,488, pending outcome of the litigation or further agreement between the parties.

**6. Effect Of Accounting Change**

During fiscal year 1997, the System adopted the provisions of GASB No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and GASB No.26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*. The provisions of these statements require restatement of prior year balances for the effect of changing from reporting investments at cost to fair value. The effect of the accounting change on net assets held in trust for the System for the fiscal year at June 30, 1996 as previously reported is as follows:

	<u>ERS</u>	<u>MERS</u>	<u>SPRBT</u>	<u>JRBT</u>	<u>PHF</u>	<u>Total</u>
June 30, 1996 net assets held in trust for pension benefits, as previously reported	\$3,162,330,163	\$438,359,918	\$3,142,473	\$1,365,022	\$317,042	\$3,605,514,618
Net appreciation in fair value of investments	718,628,670	125,284,252	197,415	19,496	0	844,129,833
June 30, 1996 net assets held in trust for pension benefits; as restated	<u>\$3,880,958,833</u>	<u>\$563,644,170</u>	<u>\$3,339,888</u>	<u>\$1,384,518</u>	<u>\$317,042</u>	<u>\$4,449,644,451</u>

**REQUIRED SUPPLEMENTARY INFORMATION**

*Schedules Of Funding Progress*

**ERS (State Employees)**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Unfunded Frozen Actuarial Liability (UFAL) (b)	Frozen Initial Liability (c) = (a + b)	Funded Ratio (a / c)	Covered Payroll (d)	UFAL as a Percentage of Covered Payroll (b / d)
6/30/96	\$ 1,529,403,200	\$ 444,814,700	\$ 1,974,217,900	77.5%	\$ 452,608,500	98.3%
6/30/95	1,345,530,000	442,370,600	1,787,900,600	75.3%	440,574,000	100.4%
6/30/94	1,234,373,500	438,794,100	1,673,167,600	73.8%	454,687,000	96.5%
6/30/93	1,151,128,700	434,225,700	1,585,354,400	72.6%	444,572,000	97.7%
6/30/92	1,056,085,500	428,793,000	1,484,878,500	71.1%	418,683,300	102.4%

**ERS (Teachers)**

6/30/96	\$ 2,181,535,900	\$ 767,893,900	\$ 2,949,429,800	74.0%	\$ 556,114,500	138.1%
6/30/95	1,824,102,300	762,202,100	2,586,304,400	70.5%	507,125,000	150.3%
6/30/94	1,642,292,300	754,727,900	2,397,020,200	68.5%	485,325,000	155.5%
6/30/93	1,492,915,800	745,698,400	2,238,614,200	66.7%	473,295,000	157.6%
6/30/92	1,352,892,300	735,319,400	2,088,211,700	64.8%	458,958,600	160.2%

**SPRBT**

6/30/96	\$ 3,115,500	\$ 560,200	\$ 3,675,700	84.8%	\$ 4,948,800	11.3%
6/30/95	1,858,800	545,700	2,404,500	77.3%	4,751,100	11.5%
6/30/94	926,300	530,800	1,457,100	63.6%	3,060,300	17.3%

**JRBT**

6/30/96	\$ 1,345,100	\$ 40,800	\$ 1,385,900	97.1%	\$ 2,596,900	1.6%
6/30/95	801,300	39,700	841,000	95.3%	2,398,400	1.7%
6/30/94	462,800	38,500	501,300	92.3%	1,521,700	2.5%

**MERS**

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)
6/30/96	\$ 564,388,311	\$ 465,004,064	\$ (99,384,247)	121.4%	\$ 153,750,203	(64.64)%
6/30/95	485,074,227	416,731,907	(68,342,320)	116.4%	151,125,008	(45.22)%
6/30/94	445,340,947	369,782,138	(75,558,809)	120.4%	133,213,341	(56.72)%

See notes to required supplementary information

## REQUIRED SUPPLEMENTARY INFORMATION

### *Schedules Of Contributions From The Employers And Other Contributing Entity*

<b>ERS</b>						
Fiscal	State Employees		Teachers (State)		Teachers (Employers)	
Year Ended June 30	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
1997	45,403,827	100%	34,871,679	100%	48,945,845	100%
1996	42,949,692	100%	30,779,586	100%	47,238,332	100%
1995	52,569,291	66%	39,528,685	83%	50,217,729	100%
1994	47,586,243	100%	30,140,281	100%	47,098,906	100%
1993	41,263,624	100%	25,276,034	100%	43,184,283	100%
1992	42,139,478	52%	23,337,935	0%	49,593,113	100%

<b>MERS</b>		
Fiscal		
Year Ended June 30	Annual Required Contribution	Percentage Contributed
1997	8,734,795	100%
1996	4,600,276	100%
1995	4,481,460	100%
1994	4,694,650	100%
1993	9,513,580	100%
1992	8,500,677	100%

<b>SPRBT</b>		
Fiscal		
Year Ended June 30	Annual Required Contribution	Percentage Contributed
1997	453,621	100%
1996	717,874	100%
1995	606,150	100%

<b>JRBT</b>		
Fiscal		
Year Ended June 30	Annual Required Contribution	Percentage Contributed
1997	618,513	100%
1996	260,299	100%
1995	155,840	100%

*See notes to required supplementary information*

***EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND***  
***Notes to Required Supplementary Schedules***  
***Fiscal Year Ended June 30, 1997***

## **1. Schedules Of Funding Progress**

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

In 1993 the Retirement Board elected to compute future fiscal year costs one extra year in advance to assist the fiscal budget process. Therefore employer costs for fiscal years ending June 30, 1997, 1998, and 1999 are based on the valuation results and data as of June 30, 1994, June 30, 1995, and June 30, 1996 respectively.

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

Historical trend information has been presented for all years which it is available.

## **2. Schedules Of Employer Contributions**

In the fiscal year ended June 30, 1994, the contributions to MERS reflect a reduction mainly due to a mark-to-market of the assets and change to the salary growth assumption from a graduated scale to a fixed 4.5% annually.

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

In the fiscal year ended June 30, 1992, ERS contributed less than 100% of the required contribution. This was the result of legislation enacted during the 1992 session of the General Assembly allowing the State to defer a portion of its required contribution to the plan. The State also made no contribution on behalf of teachers for the fiscal year ended June 30, 1992.

In the fiscal year ended June 30, 1995, ERS also contributed less than 100% of the required contribution. This is the result of fiscal year 1991 supplemental budget legislation; whereby, the State of Rhode Island (the State) withdrew \$20,788,812 from ERS. The Internal Revenue Service (IRS) determined that this action was in violation of Section 401(a) of the Internal Revenue Code (the Code). On February 4, 1994, the District Director of the IRS approved an agreement between the State and the IRS whereby the State agreed to repay to the ERS by no later than December 31, 1994, \$20,788,812 plus accrued interest at eight percent (8%) compounded monthly retroactive to March 1, 1991. As of December 31, 1994, the State repaid the amount withdrawn plus interest by designating current year contributions as payment of the obligation.

**EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND**  
**Notes to Required Supplementary Schedules**  
**Fiscal Year Ended June 30, 1997**

The SPRBT and JRBT made contributions prior to 1995 but such contributions were not based on actuarial valuations.

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				
	<i>State Employees</i>	<i>Teachers</i>	<b>MERS</b>	<b>SPRBT</b>	<b>JRBT</b>
Valuation Date	6/30/96	6/30/96	6/30/96	6/30/96	6/30/96
Actuarial Cost Method	Frozen Entry Age	Frozen Entry Age	Entry Age Normal	Frozen Entry Age	Frozen Entry Age
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	19 years	19 years	25-years from the date the unit joined the plan	26 years	26 years
Asset Valuation Method	3-Year Smoothed Market	3-Year Smoothed Market	3-Year Smoothed Market	3-Year Smoothed Market	3-Year Smoothed Market
Actuarial Assumptions					
Investment Rate of Return	8.0%	8.0%	8.0%	8.0%	8.0%
Projected Salary Increases	4.5%	4.5%	4.5%	5.5%	6.0%
Inflation	3.0%	3.0%	3.0%	3.0%	3.0%
Cost of Living Adjustments	3.0% compounded	3.0% compounded	3.0% Non-compounded	\$1,500 per annum	3.0% <i>(see Note 1(b)(4))</i>
Mortality Table	1971 Group Annuity Mortality	1971 Group Annuity Mortality	1971 Group Annuity Mortality	1971 Group Annuity Mortality	1971 Group Annuity Mortality





State of Rhode Island and Providence Plantations

ERNEST A. ALMONTE, CPA, CFE  
Auditor General

GENERAL ASSEMBLY  
**Office of the Auditor General**

1145 Main Street  
Pawtucket, Rhode Island 02860-4807

OFFICE  
(401) 277-2435  
FAX  
(401) 277-2111

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

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

We have audited the statements of plan net assets of the State of Rhode Island and Providence Plantations Employees' Retirement System (the System) as of June 30, 1997 and the related statements of changes in plan net assets for the year then ended, and have issued our report thereon dated February 13, 1998. 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 the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

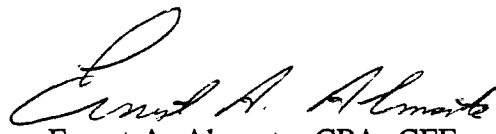
Internal Control Over Financial Reporting

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

statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the Joint Committee on Legislative Services, members of the Retirement Board, and management of the System. However, this report is a matter of public record and its distribution is not limited.

We noted certain immaterial instances of noncompliance and other matters involving the internal control over financial reporting that we will report to the management of the System in a separate communication.



Ernest A. Almonte, CPA, CFE  
Auditor General

February 13, 1998