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STATE OF RHODE ISLAND

EMPLOYEES' RETIREMENT SYSTEM

FISCAL YEAR ENDED JUNE 30, 1996

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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ERNEST A. ALMONTE, CPA, CFE  
Auditor General

GENERAL ASSEMBLY

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June 19, 1997

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, 1996 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, 1996**

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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 financial statements of the State of Rhode Island and Providence Plantations Employees' Retirement System (the System) as of and for the year ended June 30, 1996. 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 *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 1996, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 31, 1997 on our consideration of the System's internal control structure and a report dated January 31, 1997 on its compliance with laws, regulations, and contracts.

Ernest A. Almonte, CPA, CFE  
Auditor General

January 31, 1997 except for Note 12 as to  
which the date is March 12, 1997

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
BALANCE SHEET  
June 30, 1996**

	<u>Employees'</u> <u>Retirement Fund</u>	<u>Postretirement</u> <u>Healthcare Fund</u>	<u>Total</u> <u>(Memorandum Only)</u>
<b>ASSETS</b>			
Cash and cash equivalents (Note 4)	\$ 213,758,640	\$ -	\$ 213,758,640
Investments (Note 4)	2,895,149,619		2,895,149,619
Accrued interest and dividends receivable	24,533,228		24,533,228
Open trades receivable	52,559,401		52,559,401
Contributions receivable	21,510,966		21,510,966
Due from State of Rhode Island (Note 5)	<u>6,587,567</u>	<u>323,756</u>	<u>6,911,323</u>
 Total assets	 <u>\$ 3,214,099,421</u>	 <u>\$ 323,756</u>	 <u>\$ 3,214,423,177</u>
 <b>LIABILITIES AND FUND BALANCE</b>			
Liabilities:			
Cash overdraft	\$ -	\$ 6,714	\$ 6,714
Accounts and vouchers payable	2,834,601		2,834,601
Open trades payable	47,929,169		47,929,169
Payable to certain individuals (Note 6)	<u>1,005,488</u>	<u>-</u>	<u>1,005,488</u>
 Total liabilities	 51,769,258	 6,714	 51,775,972
 Fund balance available for benefits	 <u>3,162,330,163</u>	 <u>317,042</u>	 <u>3,162,647,205</u>
 Total liabilities and fund balance	 <u>\$ 3,214,099,421</u>	 <u>\$ 323,756</u>	 <u>\$ 3,214,423,177</u>

*See notes to financial statements.*

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF REVENUES, EXPENSES,  
AND CHANGES IN FUND BALANCE  
For the Fiscal Year Ended June 30, 1996**

	<u>Employees' Retirement Fund</u>	<u>Postretirement Healthcare Fund</u>	<u>Total (Memorandum Only)</u>
Operating revenues:			
Employer contributions	\$ 124,834,685	\$ 3,097,321	\$ 127,932,006
Employee/Pensioner contributions	92,824,518	1,922,063	94,746,581
Income from investments	373,303,307	21,146	373,324,453
Interest on contributions	856,042	-	856,042
Miscellaneous	<u>5,378</u>	<u>1,825</u>	<u>7,203</u>
 Total operating revenues	 <u>591,823,930</u>	 <u>5,042,355</u>	 <u>596,866,285</u>
 Operating expenses:			
Retirement benefits	236,165,513		236,165,513
Healthcare premiums	-	4,715,458	4,715,458
Refunds of contributions	5,282,043	9,855	5,291,898
Management and professional fees	8,441,027	-	8,441,027
Miscellaneous	<u>830,201</u>	<u>-</u>	<u>830,201</u>
 Total operating expenses	 <u>250,718,784</u>	 <u>4,725,313</u>	 <u>255,444,097</u>
 Operating income	 <u>341,105,146</u>	 <u>317,042</u>	 <u>341,422,188</u>
 Other financing sources (uses):			
Transfers from other funds	40,140	-	40,140
Transfers to other funds (Note 7)	<u>(2,370,361)</u>	<u>-</u>	<u>(2,370,361)</u>
 Total other financing uses	 <u>(2,330,221)</u>	 <u>-</u>	 <u>(2,330,221)</u>
 Net increase in fund balance	 <u>338,774,925</u>	 <u>317,042</u>	 <u>339,091,967</u>
 Fund balance, July 1	 <u>2,823,555,238</u>	 <u>-</u>	 <u>2,823,555,238</u>
 Fund balance, June 30	 <u>\$ 3,162,330,163</u>	 <u>\$ 317,042</u>	 <u>\$ 3,162,647,205</u>

*See notes to financial statements.*

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
Notes to Financial Statements**

**Note 1. Pension Plans**

The State of Rhode Island Employees' Retirement System (the System), is a multiple-employer, cost-sharing, public employee retirement system that acts as a common investment and administrative agent for pension benefits to be provided to State employees as well as teachers and certain other employees employed by local school districts in Rhode Island who meet eligibility requirements. The activities of the Employees' Retirement System are accounted for in the Employees' Retirement Fund and the Postretirement Healthcare Fund. The financial statements of the System are included within the Trust and Agency Funds in the State of Rhode Island Comprehensive Annual Financial Report.

**A. Pension Plan Description**

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 System are also covered and have the same benefits as State employees. The State Police and Judges have separate plans that are not included in the Employees' Retirement System.

The State's payroll for its employees that were covered by the plan for the year ended June 30, 1996, was approximately \$449 million and the total payroll, including overtime pay not subject to pension contributions, for all State employees was approximately \$662.3 million. The payroll for teachers and other local school employees covered by the plan for the year ended June 30, 1996, was \$551.3 million. RIAC's payroll for employees covered by the plan was \$2.1 million. RIEDC's payroll for transferred employees covered by the plan was \$257,000.

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. 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

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
Notes to Financial Statements**

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.

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. If a legislator is entitled under Rhode Island General Laws 36-10-10.1(a) to an annual retirement allowance which is in excess of the amount permitted by Internal Revenue Service code 415(b)(4) of \$10,000, that amount shall be paid out of the General Fund but only to the extent that the amounts have been appropriated. 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. For the year ending June 30, 1996, legislators received a maximum amount of \$10,000. Subsequently, in August 1996, Federal legislation granted relief of section 415(b)(4) of the code as it related to legislators by eliminating the \$10,000 maximum benefit amount.

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.

Rhode Island General Laws, Sections 16-16-22 and 36-10-1 require that members contribute a fixed percentage of their earnings to the System. For the year ended June 30, 1996, this percentage was 8.75% for State employees, 9.5% for teachers and other covered school employees and 30% for legislators. The contributions required by the State and various local school districts that participate in the plan are set forth in Rhode Island General Laws, Sections 16-16-22 and 36-10-2. Employer contribution rates are determined by the actuary in accordance with policies outlined in the General Laws.

Membership in the plan, as of the most recent actuarial valuation date, June 30, 1995, is as follows:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them	17,266
Active employees (including 15,130 fully vested and 2,396 eligible to retire)	<u>25,629</u>
Total	<u>42,895</u>



**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
Notes to Financial Statements**

**B. Postretirement Healthcare Plan Description**

In accordance with the General Laws, postretirement 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.

During fiscal year 1996, the State contributed 0.70% of covered payroll (exclusive of overtime) to the Postretirement Healthcare Fund to fund the estimated cost of benefits to retirees to be paid during the fiscal year.

In March of 1996, pursuant to Rhode Island General Laws 36-10-2(d), the State transferred \$2,500,000 to the General Fund to repay advances made in prior fiscal years. Subsequently, a legal opinion was rendered on September 5, 1996 that stated only advances made prior to July 1, 1993, could be repaid to the General Fund. Therefore, any advances received after July 1, 1993, are considered employer contributions. Consequently, the State's General Fund repaid \$85,558 (inclusive of interest of \$3,434) to the Postretirement Healthcare Fund on September 20, 1996.

Retirees receiving postretirement healthcare plan benefits, as of June 30, 1996, is as follows:

Pre- age 65	814
Age 65 and older	<u>1,529</u>
	<u>2,343</u>

**Note 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 Employees' Retirement System (the System) are prepared on the accrual basis of accounting. Under this method revenues are recorded when earned and expenses are recorded when incurred. 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

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
Notes to Financial Statements**

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 cost. The cost of investments sold is determined using the average cost method. Investment transactions are recorded on the date the investments are traded. Most assets of the Employees' Retirement System are held by the custodian bank (State Street Bank). On July 1, 1992, the State Investment Commission pooled the assets of the Employees' Retirement System with the assets of the Municipal Employees' Retirement System for investment purposes only, and assigned units to the Systems based on their respective share of market value. On September 29, 1994 and November 1, 1995 the assets of the State Police Retirement Benefits Trust Fund and the Judicial Retirement Benefits Trust Fund, respectively, were added to the pool for investment purposes only. The units are a function of contributions to or withdrawals from components comprising the pool.

**Cash and Cash Equivalents** - Cash represents cash held in trust in a financial institution and cash allocated to the System's investment managers for investments. Cash equivalents are highly liquid investments with a maturity of three months or less at the time of purchase.

**Foreign Currency Exchange Contracts** - The System enters 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. These securities are reported at cost in the balance sheet. They are reported in aggregate as U.S. Government and Agency Securities in the disclosure of custodial credit risk (See Note 4 on Investments). The System held no interest-only strips and principal-only strips at June 30, 1996.

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
Notes to Financial Statements**

**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.

**Note 3. Administration of the System**

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.

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. 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.

**Note 4. Cash Deposits and Investments**

**Cash Deposits**

At June 30, 1996, the carrying amount of the Employees' Retirement Fund cash deposits was \$14,942,065 and the bank balance was \$8,035,259. The bank balance represents deposits of \$716,050 in the Fund's short-term trust account which are covered by federal depository insurance and \$7,319,209 at the Fund's custodian bank which consists of uncollateralized deposits in foreign banks

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
Notes to Financial Statements**

which are not covered by United States federal depository insurance. The carrying amount of the Postretirement Healthcare Fund cash deposits was an overdraft of \$6,714 and the bank balance was an overdraft of \$18,059.

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, 1996.

**Investments**

The Employees' Retirement Fund's (the Fund) investments are pooled with other funds (see Note 2). The Fund's share of pooled investments are categorized in the following table to give an indication of the level of risk assumed by the entity at June 30, 1996:

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

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

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
Notes to Financial Statements**

The estimated market values of real estate and venture capital investments at June 30, 1996, involve subjective judgment. The actual market value of real estate can be determined only by negotiation between the parties in a sales transaction and venture capital market value can only be determined when there is an arms-length event such as when an entity goes public or when there is a negotiation between the parties in a sales transaction.

	Category			Carrying Amount	Market Value at June 30, 1996
	1	2	3		
U.S. Government and Agency Securities	\$1,199,958,846			\$1,199,958,846	\$1,242,095,950
Repurchase Agreements	1,000,000			1,000,000	1,000,000
Commercial Paper	869,810			869,810	869,810
Corporate Bonds and Notes	84,492,962			84,492,962	83,159,836
Foreign Bonds	8,466,814			8,466,814	9,027,578
Equity Securities	1,141,019,117			1,141,019,117	1,802,126,217
Foreign Equity Securities	314,198,617			314,198,617	351,776,268
	<u>\$2,750,006,166</u>			2,750,006,166	3,490,055,659
Real Estate and Venture Capital Limited Partnerships				151,016,785	145,917,077
Money Market Mutual Funds				192,943,243	192,943,243
Total				3,093,966,194	3,828,915,979
Less amount classified as cash equivalents				198,816,575	198,816,575
<b>Total Investments</b>				<b>\$2,895,149,619</b>	<b>\$3,630,099,404</b>

**Forward Foreign Currency Contracts**

The Fund may enter into forward foreign currency contracts. These contracts involve risk in excess of the amount reflected in the Fund's Balance Sheet. The face or contract amount in U.S. dollars reflects the total exposure the Fund has in that particular currency contract. 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.

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
Notes to Financial Statements**

**Interest and Principal-Only Strips**

The Fund invests in interest-only (IO) and principal-only strips (PO) (forms of mortgage-backed securities) 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. For example, if interest rates decline and homeowners refinance mortgages, thereby prepaying the mortgages underlying these securities, the cash flows from interest payments are reduced and the value of these securities declines. Likewise, if homeowners pay on mortgages longer than anticipated, the cash flows are greater and the return on the initial investment would be higher than anticipated.

Principal-only strips receive principal cash flows from the underlying mortgages. In periods of rising interest rates, homeowners tend to make fewer mortgage prepayments. If actual prepayment rates are lower than anticipated, the time remaining until the return of principal is increased. The later principal is paid, the lower the present value of the security. Conversely, higher prepayment rates return principal faster causing the PO to appreciate in market value.

**Note 5. Due From State of Rhode Island**

The balance of \$6,587,567 in the Employees' Retirement Fund relates to the State's share of retirement contributions for teachers due at June 30, 1996.

The balance of \$323,756 in the Postretirement Healthcare Fund consists of \$83,949 as of June 30, 1996 pursuant to a legal opinion (see note 1B) and \$239,807 relates to the State's contributions due at June 30, 1996.

**Note 6. Payable To Certain Individuals**

The System 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 System. Pursuant to the statute, the System 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 System. By agreement between the parties, the System 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.

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS**  
**EMPLOYEES' RETIREMENT SYSTEM**  
*Notes to Financial Statements*

**Note 7. Administrative Expenses**

Expenses of the Retirement Board and the cost of maintaining the Retirement System are paid from a restricted receipt account within the State's general fund that is used solely to pay such expenses. This account is reimbursed through the transfer of 1.5% of the investment income received by the System up to a maximum of 1.5% of the income as reported in the audited financial statements for the next preceding fiscal year. Any funds remaining at June 30 are transferred back to the System. Administrative expenses incurred by the System for the year ended June 30, 1996, amounted to \$2,289,992 and are included in transfers to other funds of \$2,370,361.

**Note 8. Funding Status and Progress**

The amount shown below as the "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure is intended to help users assess the funding status of the Employees' Retirement Fund on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among employers. The measure is the actuarial present value of credited projected benefits, and is independent of the funding method used to determine contributions to the System.

The pension benefit obligation was computed as part of the actuarial valuation performed as of June 30, 1995. Significant actuarial assumptions used in that valuation included (a) an annual rate of return on Fund investments of 8% compounded annually; (b) projected annual salary increases of 4.5%, compounded annually; (c) mortality rates based on the 1971 group annuity mortality table; (d) cost-of-living increases in pension benefits of 3% compounded annually beginning on the January 1st following the third anniversary of retirement; and (e) a retirement age of 62½ for State employees and 61 for teachers or completion of service requirement, if later.

The total unfunded pension benefit obligation, expressed in thousands, at June 30, 1995, is summarized on the next page:

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS**  
**EMPLOYEES' RETIREMENT SYSTEM**  
**Notes to Financial Statements**

<u>Pension benefit obligation:</u>	<u>State Employees</u>	<u>Teachers</u>	<u>Total</u>
Retirees and beneficiaries receiving benefits and terminated employees not yet receiving benefits	\$ 999,593	\$ 1,193,036	\$ 2,192,629
Current employees			
Accumulated employee contributions	262,697	394,708	657,405
Employer-financed vested	404,843	740,356	1,145,199
Employer-financed nonvested	<u>64,863</u>	<u>116,400</u>	<u>181,263</u>
Total pension benefit obligation	1,731,996	2,444,500	4,176,496
Net assets at June 30, 1995 available for benefits at carrying value (market value is \$3,386,045)	<u>1,170,928</u>	<u>1,652,627</u>	<u>2,823,555</u>
Unfunded pension benefit obligation	<u>\$ 561,068</u>	<u>\$ 791,873</u>	<u>\$ 1,352,941</u>

**Note 9. Actuarially Determined Contribution Requirements and Contributions Made**

The funding policy, as set forth in Rhode Island General Laws, Section 36-10-2 provides for actuarially determined periodic contributions to the System. Employer contributions to the System 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. The significant actuarial assumptions used to compute the actuarially determined contribution requirement are the same as those used to compute the pension benefit obligation.

In fiscal 1996, the actuarially determined employer contribution rate effective August 11, 1995 for State employees was 10.45% of current-year covered payroll. However, the statutorily determined employee contribution rate was increased 1% for both state employees' and teachers consequently reducing the employer rate by 1%. As a result, the employer contribution rate for state employees was 9.45%. These rates yielded a total contribution of \$42,956,379



**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
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Notes to Financial Statements**

by the State for its employees. This amount consisted of \$16,055,941 for normal cost and \$26,900,438 for amortization of the unfunded actuarial accrued liability

The State also contributed \$2,888,605 or 0.70% of the current-year covered payroll to the Postretirement Healthcare Fund.

The state employees contribution rate was increased 1%, effective August 11, 1995, to 8.75% of current-year covered payroll. These rates yielded a total contribution of \$38,804,197.

The State's required contribution for teachers was \$33,348,193. In communities which had previously adopted early retirement incentives, the State contributed 6.22% of covered payroll. For communities that did not adopt early retirement incentives, the State contributed 5.54% of covered payroll. Municipalities were required to contribute \$49,392,816. In communities which had previously adopted early retirement incentives this amounted to 8.49% of covered payroll and 7.47% for communities that did not.

***Note 10. Historical Trend Information***

Historical trend information, designed to provide information about the Fund's progress made in accumulating sufficient assets to pay benefits when due, is presented in the Required Supplementary Information section of this report.

***Note 11. Related Party Transactions***

As of June 30, 1996, the Employees' Retirement Fund held investments in bonds issued by the R.I. Housing and Mortgage Finance Corporation totaling \$4,205,000 and the R.I. Industrial Facilities Corporation totaling \$23,000,000. These entities are included as discretely presented proprietary component units in the State of Rhode Island Comprehensive Annual Financial Report.

***Note 12. Contingencies***

A claim has been made by a former member of the System that he is entitled to interest on the refund of his contribution. The System contests the claim for interest. At issue is not only the right to receive interest but also the rate of interest and the manner of calculation. The matter was heard before a hearing officer and on March 12, 1997, the hearing officer sustained the former member's claim. The rate at which interest should be calculated or the manner of calculation has not been determined. Accordingly, there is no reliable basis upon which to estimate the System's liability, if any.



GENERAL ASSEMBLY

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January 31, 1997

INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

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

The Analysis of Funding Progress and the Schedule of Revenues by Source and Expenses by Type appearing on the following pages 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

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
REQUIRED SUPPLEMENTARY INFORMATION  
ANALYSIS OF FUNDING PROGRESS**

(Expressed in Thousands)

Fiscal Year	(1)  Net Assets Available for Benefits *	(2)  Pension Benefit Obligation	(3)  Percentage Funded (1) / (2)	(4)  Unfunded Pension Benefit Obligation (2) - (1)	(5)  Annual Covered Payroll	(6)  Unfunded Pension Benefit Obligation as a Percentage of Covered Payroll (4) / (5)
1987	\$ 1,196,304	\$ 2,327,225	51.4%	\$ 1,130,921	\$ 624,927	181.0%
1988	1,392,277	2,569,166	54.2%	1,176,889	738,696	159.3%
1989	1,710,607	2,728,467	62.7%	1,017,860	729,859	139.5%
1990	1,896,653	3,022,835	62.7%	1,126,182	819,329	137.5%
1991	1,975,462	3,311,190	59.7%	1,335,728	824,000	162.1%
1992	2,185,752	3,576,893	61.1%	1,391,141	816,000	170.5%
1993	2,366,475 (1)	3,801,359	62.3%	1,434,884	884,000	162.3%
1994	2,562,730 (1)	4,031,993	63.6%	1,469,263	942,000	156.0%
1995	2,823,555	4,176,496	67.6%	1,352,941	988,000	136.9%

Analysis of the dollar amounts of net assets available for benefits, pension benefit obligation, and unfunded pension benefit obligation in isolation can be misleading. Expressing the net assets available for benefits as a percentage of the pension benefit obligation provides one indication of the Retirement Fund's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the Fund is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the Fund. Trends in the unfunded pension benefit obligation and annual covered payroll are both affected by inflation. Expressing the unfunded pension benefit obligation as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the Fund's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the Fund. Historical trend information has been presented for all years for which it is available. The pension benefit obligation was not computed for years prior to 1987. Data for subsequent years will be added to the schedule.

\* At cost

(1) Adjusted for prior period adjustments posted in fiscal 1994 and 1995

(Unaudited)

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
EMPLOYEES' RETIREMENT SYSTEM  
REQUIRED SUPPLEMENTARY INFORMATION  
REVENUES BY SOURCE AND EXPENSES BY TYPE**

(Expressed in Thousands)

Revenues by Source

Fiscal Year	Employee Contributions	Employer Contributions	Investment Income	Other Income	Total
1987	\$ 52,133	\$ 98,940	\$ 105,976	\$ 563	\$ 257,612
1988	62,058	101,038	141,769	1,474	306,339
1989	69,381	135,140	223,375	893	428,789
1990	64,964	115,011	151,328	767	332,070
1991	69,796	61,701	140,758	751	273,006
1992	70,711	70,637	271,201	1,089	413,638
1993	74,441	133,140	192,902	2,563	403,046
1994	78,464	127,100	201,399	2,875	409,838
1995	82,622	117,399	294,258	1,889	496,168
1996	92,825	124,835	373,303	861	591,824

Expenses by Type

Fiscal Year	Benefits	Operating Expenses	Refunds	Other Expenses	Total
1987	\$ 93,565	\$ -	\$ 4,183	\$ 2	\$ 97,750
1988	104,848	560	3,981		109,389
1989	113,840	1,318	4,377	2	119,537
1990	136,495	4,148	3,844		144,487
1991	185,637	3,249	4,377		193,263
1992	191,806	5,674	4,874		202,354
1993	199,962	4,765	3,904		208,631
1994	206,824	7,584	4,226	417	219,051
1995	218,511	5,988	6,142	2,632	233,273
1996	236,166	8,441	5,282	830	250,719

Data for 1987 through 1988 is reported on the cash basis; data for 1989 through 1996 is reported on the accrual basis.

(Unaudited)



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January 31, 1997

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### INDEPENDENT AUDITOR'S REPORT ON THE INTERNAL CONTROL STRUCTURE

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

We have audited the financial statements of the State of Rhode Island and Providence Plantations Employees' Retirement System (the System) as of and for the year ended June 30, 1996, and have issued our report thereon dated January 31, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *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.

The management of the System is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the System for the year ended June 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we

Joint Committee on Legislative Services

Page 2


January 31, 1997

assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our consideration of the control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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 structure and its operations that we consider to be material weaknesses as defined above.

However, we noted other matters involving the internal control structure and its operation that we will report to the management of the System, in a separate letter dated January 31, 1997.

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.



Ernest A. Almonte, CPA, CFE  
Auditor General



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January 31, 1997

### INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS, REGULATIONS AND CONTRACTS

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

We have audited the financial statements of the State of Rhode Island and Providence Plantations Employees' Retirement System (the System) as of and for the year ended June 30, 1996, and have issued our report thereon dated January 31, 1997.

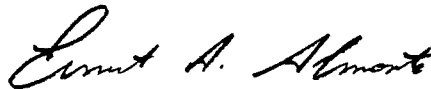
We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, and contracts applicable to the System is the responsibility of the System's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the System's compliance with certain provisions of laws, regulations, and contracts. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*. We noted certain immaterial instances of noncompliance that we will report to the management of the System in a separate letter dated January 31, 1997.

Joint Committee on Legislative Services  
Page 2  
January 31, 1997

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.

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

Ernest A. Almonte, CPA, CFE  
Auditor General