

**EMPLOYEES' RETIREMENT SYSTEM
OF THE CITY OF NORFOLK**

Financial Statements
and
Supplementary Information
for the Years Ended
June 30, 2001 and 2000

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

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EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

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Independent Auditors' Report

To the Board of Trustees
Employees' Retirement System of the City of Norfolk
Norfolk, Virginia

We have audited the accompanying statement of plan net assets of the Employees' Retirement System of the City of Norfolk (the "System"), a component unit of the City of Norfolk, Virginia, as of June 30, 2001, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the System as of June 30, 2000, were audited by other auditors whose report dated October 12, 2000, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Specifications for Audits of Counties, Cities and Towns*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. 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, the accompanying financial statements present only the System and are not intended to present fairly the financial position of the City of Norfolk, Virginia, and the results of operations of its fiduciary fund types in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2001 on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information on pages 12 through 14 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. The information included for 1996 through 2000 was derived from financial statements audited by other independent accountants and from prior years' actuarial reports. Our procedures were limited to agreeing such information to audited financial statements and prior years' actuarial reports.

Cherry, Bekeert & Hallam, J.P.

Richmond, Virginia
September 18, 2001

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

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Statements of Plan Net Assets June 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Assets		
Cash and short-term investments	\$ 32,153,223	\$ 53,452,871
Receivables:		
Accrued investment income	4,813,822	4,237,979
Due from broker for securities sold	<u>33,710,627</u>	<u>2,659,981</u>
Total receivables	<u>38,524,449</u>	<u>6,897,960</u>
Investments, at fair value:		
United States Government securities	76,622,745	48,220,093
Corporate bonds and debentures, including obligations of national mortgage associations	315,233,316	318,543,319
Common stocks	288,676,815	249,000,549
Domestic equity funds	112,377,092	194,781,827
Domestic bond fund	<u>57,582,863</u>	<u>51,794,066</u>
Total investments	<u>850,492,831</u>	<u>862,339,854</u>
Total assets	<u>921,170,503</u>	<u>922,690,685</u>
Liabilities		
Accounts payable	1,180,090	614,770
Due to broker for securities purchased	<u>95,841,147</u>	<u>45,795,992</u>
Total liabilities	<u>97,021,237</u>	<u>46,410,762</u>
Net assets held in trust for pension benefits (A schedule of funding progress is presented on page 12)	<u>\$ 824,149,266</u>	<u>\$ 876,279,923</u>

See notes to financial statements.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

Statements of Changes in Plan Net Assets June 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Additions:		
Investment income:		
Net (depreciation) appreciation in fair value of investments	\$ (44,870,557)	\$ 47,968,455
Interest	24,519,361	22,861,069
Dividends	3,350,245	3,457,147
Other	60,358	65,545
	<u>(16,940,593)</u>	<u>74,352,216</u>
Less investment expense	<u>(2,711,999)</u>	<u>(1,965,215)</u>
Net investment income (loss)	<u>(19,652,592)</u>	<u>72,387,001</u>
Deductions:		
Benefits paid directly to participants	29,836,997	28,863,255
Refunds of contributions	95,576	62,846
Beneficiary payments	2,042,581	2,055,261
Administrative fees	502,911	615,092
	<u>32,478,065</u>	<u>31,596,454</u>
Total deductions	<u>32,478,065</u>	<u>31,596,454</u>
Net increase (decrease)	<u>(52,130,657)</u>	<u>40,790,547</u>
Net assets held in trust for pension benefits:		
Beginning of year	<u>876,279,923</u>	<u>835,489,376</u>
End of year	<u>\$ 824,149,266</u>	<u>\$ 876,279,923</u>

See notes to financial statements.

**Notes to Financial Statements
June 30, 2001 and 2000****Note 1 - Significant accounting policies**

Basis of accounting – The financial statements of the Employees' Retirement System of the City of Norfolk (the "System") are prepared using the accrual basis of accounting. Employer contributions are recognized when due. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

The System has applied the provisions of Governmental Accounting Standards Board Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* ("GASB 25") in the preparation of these financial statements. GASB 25 establishes financial reporting standards for defined benefit pension plans and for the notes to the financial statements of defined contribution plans of state and local governmental entities and requires two basic financial statements, a statement of plan net assets and a statement of changes in plan net assets, that provide current financial information about plan assets and financial activities. Actuarially determined information, from a long-term perspective, about funded status of the plan and related progress is presented in two required schedules, a schedule of funding progress and a schedule of employer contributions. GASB 25 also establishes certain parameters for the measurement of all actuarially determined information included in financial reports of defined benefit pension plans.

Investment valuation method – Investments are stated at fair value. Short-term investments are recorded at cost, which approximates fair value. Securities traded on a national securities exchange are valued at the last reported sales price on the last business day of the System's fiscal year. Investments that do not have an established market are reported at estimated fair value. Purchases and sales of securities traded but not yet settled at year-end are recorded as due to broker for securities purchased and due from broker for securities sold, respectively.

Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of changes in net assets during the reporting period. Actual results could differ from those estimates.

Note 2 – Description of the plan

The System is the administrator of a single-employer noncontributory defined benefit plan that covers substantially all employees of the City of Norfolk, Virginia, excluding School Board employees who are covered by the Virginia Retirement System. Although the System presents separate financial statements, it is also included as a component unit in the City of Norfolk's Comprehensive Annual Financial Report as a pension trust fund. The types of employees covered and current membership as of June 30, 2001 and 2000 consists of the following:

Notes to Financial Statements June 30, 2001 and 2000

Note 2 – Description of the plan (concluded)

Retirement (for employees who became members on or after January 1, 1997): Normal retirement is the attainment of age 60 for general employees, and age 55 or after the completion of 25 years of credited service for public safety employees. The normal service retirement benefit per annum for general employees is generally equal to 1.75 percent of average final compensation multiplied by the number of years of creditable service up to a maximum of 35 years of creditable service for general employees. The normal service retirement benefit per annum for public safety employees is generally equal to 2.2 percent of average final compensation for the first 25 years of creditable service and 2.0 percent of average final compensation for the next 5 years of creditable service capped at 65 percent of pay for public safety employees.

During the year ended June 30, 1997, the City adopted various amendments to the retirement benefits of active members effective January 1, 1997. The amendments were as follows:

- Capped years of eligible services for general employees

- Capped percent of pay for public safety employees at 65%

- Increased benefit accrual rates for various employee groups

- Changed the age for both the normal service requirement and early service requirement for various employee groups

- Decreased the early service retirement penalty for general employees

- Changed the vesting requirements for all employees from ten years to five years

- Allowed permanent part-time employees to earn prospective retirement benefits

- Allowed employees who return to work after a break-in-service to repurchase creditable service time

The System also provides for ordinary death and disability benefits and accidental death and disability benefits. Ad hoc cost-of-living adjustments ("COLAs") are provided at the discretion of the City Council. Participants should refer to the Plan document for a complete description of these benefits.

The Employees' Retirement System is established by Section 37 of the Code of the City of Norfolk, Virginia, 1979, as amended 1997. The benefit provisions of the Plan are also determined by this Code section.

**Notes to Financial Statements
June 30, 2001 and 2000****Note 3 – Contributions required and contributions made**

Significant assumptions used to calculate contribution requirements are the same as those used to calculate the actuarial accrued liability. Normal cost is funded on a current basis. Periodic contributions for normal cost are based on the level percentage-of-payroll method. There is no unfunded actuarial accrued liability at June 30, 2001 or 2000. The funding strategy for normal cost should provide sufficient resources to pay employee pension benefits on a timely basis.

Section 37 of the Code of the City of Norfolk, Virginia, 1979, as amended 1997 establishes the authority under which the employer's obligation to contribute to the plan is established or may be amended. There were no contribution requirements to the pension plan for the years ended June 30, 2001 and 2000. Contribution requirements are actuarially determined at the end of each fiscal year and paid by the City of Norfolk in the ensuing year. The contribution requirement of \$-0- for the year ended June 30, 2001 was based on -6.18 percent of covered payroll for general employees and 2.87 percent of covered payroll for public safety employees. The contribution requirement of \$-0- for the year ended June 30, 2000 was based on -3.55 percent of covered payroll for general employees and 5.56 percent of covered payroll for public safety employees. The contribution percentage for general employees for 2001 and 2000 is negative due to the overfunded status of the Plan.

Voluntary contributions were discontinued in 1979 and have been accumulated thereafter with interest at a rate of 7 percent. Such contributions are refundable to members who terminate before becoming eligible for retirement benefits. At retirement, members' contributions plus accumulated interest are refunded. Such amounts approximated \$472,000 and \$533,000 at June 30, 2001 and 2000, respectively.

Note 4 – Investments and deposits

Deposits – At June 30, 2001 and 2000, the carrying amounts of the System's cash deposits with banks and investment companies were \$7,099,832 and \$3,060,969, respectively, and the bank and investment company balances were \$7,969,161 and \$3,797,779, respectively. The entire bank balance was covered by federal depository insurance, commercial insurance or collateralized in accordance with the Virginia Security for Public Deposits Act. Under the Act, banks holding public deposits in excess of the amounts insured by FDIC must pledge collateral in the amount of 50% of excess deposits to a collateral pool in the name of the State Treasury Board. The State Treasury Board is responsible for monitoring compliance with the collateralization and reporting requirements of the Act and for notifying local governments of compliance by banks.

Investments – The Code of Virginia authorizes the System to invest in certificates of deposit with national banks located within the Commonwealth of Virginia, obligations of the United States or its agencies, bankers' acceptances, repurchase agreements, "prime quality" commercial paper, common stock, and certain other qualified investments.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

Notes to Financial Statements June 30, 2001 and 2000

Note 4 – Investments and deposits (continued)

The System's investments at June 30, 2001 and 2000 are categorized in the following table to give an indication of the level of credit risk assumed by the System at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the System or its safekeeping agent in the System's name. Category 2 includes uninsured or unregistered investments for which the securities are held by the broker's or dealer's trust department or safekeeping agent in the System's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or safekeeping agent but not in the System's name. The System's investments at June 30, 2001 and 2000 are as follows:

	2001				
	At cost			Total Cost	Carrying Amount
	Category 1	Category 2	Category 3		
U.S. Government securities	\$ 76,219,972	\$ -	\$ -	\$ 76,219,972	\$ 76,622,745
Corporate bonds and debentures, including commercial paper classified as cash and short-term investments	313,581,709	-	-	313,581,709	315,233,316
Common stocks	284,954,998	-	-	284,954,998	288,676,815
	<u>\$ 674,756,679</u>	<u>\$ -</u>	<u>\$ -</u>	<u>674,756,679</u>	<u>680,532,876</u>
State Street Conservative Fund				38,676,586	112,377,092
State Street Global Advisors Bond Market Fund				50,100,452	57,582,863
Money market investments included in cash and short-term investments				25,053,391	25,053,391
				<u>788,587,108</u>	<u>875,546,222</u>
Less: funds classified as cash equivalents				<u>25,053,391</u>	<u>25,053,391</u>
Total investments				<u>\$ 763,533,717</u>	<u>\$ 850,492,831</u>
	2000				
	At cost			Total Cost	Carrying Amount
	Category 1	Category 2	Category 3		
U.S. Government securities	\$ 47,635,273	\$ -	\$ -	\$ 47,635,273	\$ 48,220,093
Corporate bonds and debentures, including commercial paper classified as cash and short-term investments	333,032,681	-	-	333,032,681	328,797,646
Common stocks	202,100,728	-	-	202,100,728	249,000,549
	<u>\$ 582,768,682</u>	<u>\$ -</u>	<u>\$ -</u>	<u>582,768,682</u>	<u>626,018,288</u>
State Street Russell 1000 Growth Fund				43,907,577	65,061,934
State Street Conservative Fund				36,794,586	129,719,893
State Street Global Advisors Bond Market Fund				50,100,452	51,794,066
Money market investments included in cash and short-term investments				40,137,575	40,137,575
				<u>753,708,872</u>	<u>912,731,756</u>
Less: funds classified as cash equivalents				<u>50,391,902</u>	<u>50,391,902</u>
Total investments				<u>\$ 703,316,970</u>	<u>\$ 862,339,854</u>

(continued)

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

Notes to Financial Statements June 30, 2001 and 2000

Note 4 – Investments and deposits (concluded)

The System's investments, (including investments bought and sold, as well as held throughout the year), appreciated (depreciated) in fair value as determined by quoted market prices as follows during the years ended June 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
U.S. Government and government agencies securities	\$ 2,114,214	\$ 750,612
Corporate bonds and debentures	19,539,339	(4,865,187)
Common stocks and equity funds	<u>(66,524,110)</u>	<u>52,083,030</u>
	<u>\$ (44,870,557)</u>	<u>\$ 47,968,455</u>

The System invests in certain derivatives including real estate mortgage investment conduits and collateralized mortgage obligations. Those securities are included in reported investments. Investments in derivatives with a cost of \$76,754,976 and \$46,213,462 and a market value of \$77,397,858 and \$45,515,472 were held at June 30, 2001 and 2000, respectively.

Subsequent to year end, financial markets in general and equity markets in particular have had significant declines in value.

Note 5 – Transactions with City of Norfolk

Beginning January 1, 1992, the System began reimbursing the City for all administrative costs related to the System's operations. The costs reimbursed for the years ended June 30, 2001 and 2000 were \$283,905 and \$441,531, respectively.

Note 6 – Income tax status

The Internal Revenue Service has ruled that the Plan qualifies under Section 401-1(b)(3) of the Internal Revenue Code and is, therefore, not subject to tax under present income tax laws. Although the Plan has been amended since receiving a determination letter from the Internal Revenue Service, the Plan administrator believes that the Plan is designed and is currently being operated in compliance with the applicable requirements of the Internal Revenue Code.

Note 7 – Subsequent events

The June 30, 2001 benefit obligations reflect the following changes in the benefit provisions effective July 1, 2001:

- (a) The benefit formula for general employees who became members after June 30, 1980 was changed to 1.75% of average final compensation times years of creditable service, with service limited to 35 years. This change increased benefit obligations by \$1,987,759.

(continued)

Notes to Financial Statements June 30, 2001 and 2000

Note 7— Subsequent events (concluded)

- (b) Eligibility for normal service retirement for general employees who became members after June 30, 1980 was changed to the earlier of age 60 or the age at which the member has at least 30 years of service, which are the same eligibility requirements for pre-July 1, 1980 members. The actuarially assumed rates of retirement also were changed for post-June 30, 1980 members to the same rates used for pre-July 1, 1980 members. These changes increased benefit obligations by \$7,756,096.
- (c) The benefit formula for public safety employees was changed to 2.5% of average final compensation times years of creditable service, not to exceed 65% of average final compensation. This change increased benefit obligations by \$31,533,113.
- (d) The additional monthly benefit payable to qualified members earning a pension under \$500 became permanent and payable by the retirement system. This change increased benefit obligations by \$185,876.
- (e) Retirees and beneficiaries as of December 31, 2000 were granted a permanent 3% supplemental benefit increase. This change increased benefit obligations by \$9,275,973.

The system also adopted portability and service purchase provisions. Cost for service credited under these provisions is actuarially determined and borne by the member or the transferring system and is assumed to have no cost impact on the Norfolk retirement system.

SUPPLEMENTARY INFORMATION

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

Schedule of Funding Progress Dollar Amounts in Millions

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) - Projected Unit Credit (b)</u>	<u>Funding Excess (a-b)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>Funding Excess as a Percentage of Covered Payroll ((a-b)/c)</u>
June 30, 1996	\$ 534.8	\$ 469.4	\$ 65.4	113.9%	\$ 118.0	55.4%
June 30, 1997	609.2	550.1	59.1	110.7%	116.8	50.6%
June 30, 1998	694.2	569.9	124.3	121.8%	121.9	102.0%
June 30, 1999	767.8	601.4	166.4	127.7%	122.4	135.9%
June 30, 2000	826.4	628.2	198.2	131.6%	129.9	152.6%
June 30, 2001	838.1	724.7	113.4	115.6%	144.2	78.6%

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

Schedule of Employer Contributions

<u>Year Ended June 30,</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
1996	\$ 9,903,324	100%
1997	12,132,036	100
1998	10,158,768	100
1999	3,456,936	100
2000	-	100
2001	-	100

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF NORFOLK

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Notes to Supplementary Actuarial Information

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.

Valuation date	June 30, 2001
Actuarial cost method	Projected unit credit cost method
Amortization method	Level dollar closed
Remaining amortization period	Weighted average of 17.5 years
Asset valuation method	3-year moving average market
Actuarial assumptions:	
Investment rate of return*	7.5% per annum, compounded annually
Projected salary increases*	Average salary increases of 5.35%, compounded annually (This reflects an assumption of a range of salary increases from 7.6% at age 20 to 4.6% at age 69.)
*Includes inflation at 3.5%	
Cost-of-living adjustments	None
Separation from active service	Assumed rates of separation from service vary depending on the age of the employee and whether the employee is a general employee or public safety employee. 1995 George B. Buck mortality tables with ages rated forward 3 years for members and 4 years for beneficiaries. Special mortality tables are used for disability retirements.
Marital status	65% of the general employees and 80% of the public safety employees are assumed to be married, with the males three years older than females.

George B. Buck Consulting Actuaries, Inc. computes the actuarial accrued liability. The actuarial assumptions above are based on the presumption that the System will continue indefinitely. Were the System to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial accrued liability.

The actuarial valuation for June 30, 1998 reflects an increase in the actuarial accrued liability of approximately \$3.0 million due to the establishment of a 2 percent permanent cost of living adjustment effective January 1, 1998.