

Financial Section

DELAWARE
PUBLIC
EMPLOYEES'
RETIREMENT
SYSTEM

- a component unit of the State of Delaware



STATE OF DELAWARE
OFFICE OF AUDITOR OF ACCOUNTS

 **ERNST & YOUNG LLP**

Report of Independent Auditors

State of Delaware
Board of Pension Trustees

We have audited the Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets of the Delaware Public Employees' Retirement System (System) as of June 30, 2002, and 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 auditing standards generally accepted in 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 status of the System at June 30, 2002, and the changes in its financial status for the year then ended, in conformity with accounting principles generally accepted in the United States.

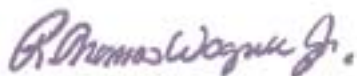
Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Management's Discussion and Analysis and schedules of funding progress, employer contributions, and notes to trend data are presented in accordance with Governmental Accounting Standards Board Statements Nos. 34 and 25, respectively. Such information has been subjected to the auditing procedures applied in our 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.



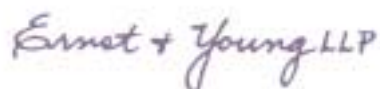
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The supporting schedules of administrative expenses and investment expenses for the year ended June 30, 2002, on Schedules 4 and 5 are not a required part of the basic financial statements. Such supporting schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements for the year ended June 30, 2002, and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

We did not audit the data included in the introductory, investment, actuarial and statistical sections of this report and, therefore, express no opinion thereon.



Auditor of Accounts
Dover, Delaware



Ernst & Young LLP
Philadelphia, Pennsylvania

August 16, 2002

Management's Discussion and Analysis

This discussion and analysis of the Delaware Public Employees' Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended June 30, 2002. It is intended to be a narrative supplement to the System's financial statements, which begin on page 24 of this report.

Financial Highlights

The following financial highlights occurred during the fiscal year ended June 30, 2002:

- Plan net assets of all the pension funds administered by the System decreased by \$422.9 million during the 2001-2002 fiscal year.
- The covered payroll requiring both employee and employer pension contributions reported during the year totaled \$1,425.1 million, representing an increase of 15.4%. Employee contributions increased by 6.1% and employer contributions increased by 9.9%.
- Net investment losses (net decrease in fair value, plus investment earnings, less investment administrative expenses) increased by 9.3% compared to last fiscal year. Continued adverse equity market conditions were the primary cause of the decrease compared to the prior year.
- Pension benefits paid to retirees and beneficiaries increased \$20.4 million bringing the total benefit payments to \$216.4 million. Post-retirement increases and changes to benefit multipliers are responsible for the 10.4% increase in pension benefits. Refunds of contributions paid to former members upon termination of employment increased slightly from \$2.6 million to \$2.7 million.
- Administrative expenses and other project specific expenses totaled \$4.6 million, a decrease of 6.8% compared to last fiscal year. (See Schedule 4 on page 46 for more details.)

Using this Financial Report

Because of the long-term nature of a defined benefit pension plan, financial statements alone cannot provide sufficient information to properly reflect the System's ongoing plan perspective. This financial report consists of two financial statements and two required schedules of historical trend information. The Statement of Plan Net Assets and Statement of Changes in Plan Net Assets (pages 24–27) provide information about the activities of the nine individual pension plans administered and the four funds managed, as well as comparative summary information about these activities for the System as a whole.

The Schedule of Funding Progress (pages 40–41) includes historical trend information about the actuarially funded status of each plan from a long-term, ongoing plan perspective and the progress made in accumulating sufficient assets to pay benefits when due. The Schedule of Employer Contributions (pages 42–43) presents historical trend information about the annual required contributions of employers and the contributions made by employers in relation to this requirement. These schedules provide information that contributes to understanding the changes over time in the funded status of the plans.

Analysis of Plan Net Assets

The System was created to provide retirement, survivor, and disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments as designated by the various plans, refunds of member contributions to terminated employees, and the cost of administering the System. Combined plan net assets declined by \$422.9 million over the last fiscal year. Looking at additions to and deductions from Plan net assets, this decline is attributable to both economic conditions and legislative changes increasing benefit multipliers.

Plan Net Assets

(Dollar values expressed in thousands)

Fiscal Years Ending June 30,	2002	2001	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Cash and Investments at Fair Value	\$ 4,854,368	\$ 5,278,051	\$ (423,683)	(8.0%)
Receivables	4,737	4,423	314	7.1%
Total Assets	4,859,105	5,282,474	(423,369)	(8.0%)
Total Liabilities	1,409	1,857	(448)	(24.1%)
Total Plan Net Assets	\$ 4,857,696	\$ 5,280,617	\$ (422,921)	(8.0%)

Changes in Plan Net Assets

(Dollar values expressed in thousands)

Fiscal Years Ending June 30,	2002	2001	Increase/ (Decrease) Amount	Increase/ (Decrease) Percent
Additions:				
Employer Contributions	\$ 82,469	\$ 75,025	\$ 7,444	9.9%
Transfer of Contributions from PRI Fund	32,322	38,526	(6,204)	(16.1%)
Transfer of Assets from Outside the System	4,685	3,239	1,446	44.6%
Member Contributions	37,731	35,550	2,181	6.1%
Other Income	7	21	(14)	(66.7%)
Net Investment Losses	(313,816)	(287,086)	(26,730)	(9.3%)
Total Additions	\$ (156,602)	\$ (134,725)	\$ (21,877)	(16.2%)
Deductions:				
Transfer of Contributions from PRI Fund	\$ 32,322	\$ 38,526	\$ (6,204)	(16.1%)
Transfer of Assets Outside the System	6,232	2,710	3,522	130.0%
Benefit Payments	216,353	195,971	20,382	10.4%
Refunded Contributions	2,698	2,610	88	3.4%
Group Life Payments	4,080	3,710	370	10.0%
General Administrative Expenses	4,134	3,623	511	14.1%
PRIDE Project Expenses	--	379	(379)	(100.0%)
eCRIS Project Expenses	478	--	478	100.0%
Health Liability Study	--	45	(45)	(100.0%)
Office Relocation Expenses	22	925	(903)	(97.6%)
Total Deductions	\$ 266,319	\$ 248,499	\$ 17,820	7.2%
(Decrease) in Plan Net Assets:	\$ (422,921)	\$ (383,224)	\$ (39,697)	(10.4%)



Employer contributions increased approximately \$7.4 million because of higher required actuarial contribution rates, an increase in salaries, and an increased number of member employers. Member contributions increased by approximately \$2.2 million due to an increase in the number of active employees and an increase in salaries. The 5-year actuarial funding for eliminating social security integration and maximum years of service limitation from the pension benefit calculation in the State Employees' and Judiciary Plans has been completed. This reduced transfers from the Post-Retirement Increase Fund.

Transfers of Assets Outside the System represents transfers from the County & Municipal Police/Firefighters' COLA Fund (COLA Fund) to individual participating entities. During fiscal 2002, there were funds totaling approximately \$2.5 million reverted from the COLA Fund to the General Fund as stipulated by statute. Benefit payments increased by approximately 10.4% as a result of legislation which provided for a post-retirement increase effective July 1, 2001, as well as a modification to the pension multiplier in the State Employees' Pension Plan. Total administrative expenses (including general administrative, PRIDE Project, eCRIS project, health liability study, and office relocation) for fiscal 2002 were approximately \$4.6 million, a decrease of 6.8%. These expenses include both the normal administrative expenses of the Pension Office, as well as special projects. General administrative expenses totaled \$4.1 million, an increase of 14.1% over Fiscal 2001. This increase includes a 100% increase in lease payments for the new location, as well as a 16.9% increase in fringe benefit costs mainly due to increased health care premiums. Enhancements to the phone system increased expenses in the telephone communications area. In the Data Processing maintenance category, upgraded software required increased maintenance contract fees by 35.8%.

Investments

For fiscal 2002, investments had a (6.3%) rate of return. The total System's annualized rate of return over the last five and ten years was 6.4% and 10.6%, respectively. This performance placed the System slightly below the median for public fund return for the fiscal year and in the top 10% of public funds for the five and ten year periods.

System investments are managed to control the extent of downside risk to which assets are exposed while maximizing long-term gain potential. This positions the System to limit the impact of adverse market conditions. Portfolio diversification is an important element of investment risk control.

The investment activity of the System is governed by the "prudent person rule". The prudent person rule establishes a standard for all fiduciaries, which includes anyone who has authority with respect to the System. The prudent person rule states that fiduciaries shall discharge their duties solely in the interest of the System participants and beneficiaries and with the degree of diligence, care, and skill which a prudent person would ordinarily exercise under similar circumstances.

The prudent person rule permits the Board to establish an investment policy based upon certain investment criteria and allows for the delegation of investment authority to professional investment managers. Page 53 shows the System's investment policy. Investment constraints are outlined, including the appropriate degree of risk. Investment managers are hired to execute the investment policy. They have full discretion for investment decisions within statutory authority, Board policy, and their respective guidelines. A list of the investment managers under contract with the System as of June 30, 2002, may be found on page 57 of this report. A summary of the total System's asset allocation can be found on page 56.