Annual Financial Report of the University of California Retirement System

University of California Retirement Plan
Fiscal Year Ended June 30, 1997

Annual Financial Report
of the
University of California
Retirement System

University of California Retirement Plan – a Defined Benefit Pension Plan

Fiscal Year Ended June 30, 1997

UCRS Plan Administration

Summary Statement

This report contains information about the University of California Retirement Plan for the fiscal year ended June 30, 1997, and includes audited financial statements. Significant statistics relating to the Plan and its membership base as of the 1996–97 fiscal year end are as follows:

Net assets	$29,128,480,000
Net dividend and interest income	$871,540,000
Benefit payments (excluding member withdrawals and lump sum cashouts)	$572,502,000
Plan administrative expenses	$12,357,000

Active Plan Membership

Senate Faculty and Non-Faculty Academics	16,813	members
Management/Senior Professional	16,533	members
Professional/Support Staff	60,058	members
▪ Average annual salary—		
Senate Faculty	$81,086	
Non-Faculty Academics	$49,450	
Management/Senior Professional	$60,103	
Professional/Support Staff	$36,798	
▪ Average age—		
Senate Faculty	48	years
Non-Faculty Academics	42	years
Management/Senior Professional	45	years
Professional/Support Staff	42	years

Inactive Plan Membership

28,778 members

Annuitant Membership

Faculty	3,380	retirees
Management/Senior Professional	13,107	retirees
Professional/Support Staff	8,293	retirees
▪ Average retirement age—		
Faculty	64	years
Management/Senior Professional	59	years
Professional/Support Staff	60	years
▪ Average service credit at retirement—		
Faculty	27	years
Management/Senior Professional	22	years
Professional/Support Staff	13	years
▪ Average annual UCRP income—		
Faculty	$45,884	
Management/Senior Professional	$22,330	
Professional/Support Staff	$8,267	
Survivor/Beneficiary	3,541	recipients
Disabled	1,338	recipients

Plan Overview & Administration

The University of California Retirement Plan (UCRP) is a valuable component of the comprehensive benefits package offered to employees of the University of California, its affiliate, Hastings College of the Law, and Associated Students of UCLA. The Plan is a governmental defined benefit pension plan qualified under §401(a) of the Internal Revenue Code (IRC).

The University's pension program dates back to 1904, with a plan that provided for the purchase of commercial annuities for retiring professors at UC Berkeley and UC San Francisco. The current Plan was designed in 1961, prior to the University's participation in Social Security and before the introduction of employee life and disability insurance benefits. Over the years, the Plan has evolved to include provisions for:

- basic retirement income with four payment options;
- disability benefits;
- death benefits;
- preretirement survivor benefits; and
- annual, automatic adjustments for increases in the cost of living for retirees and inactive members.

Further, in lieu of lifetime retirement benefits, members may choose a refund of their accumulated Plan contributions and earnings or, if eligible to retire, they may cash out of the Plan entirely by electing a lump sum payment equal to the present value of their accrued retirement benefit.

At June 30, 1997, 93,404 employees at the University's nine campuses, five medical centers, three Department of Energy laboratories, Hastings College of the Law, and ASUCLA were active UCRP members.

The President of the University of California is the Plan Administrator and delegates the responsibility for the day-to-day management and operation of the Plan to the Employee Benefits Plan Administration department. This department conducts policy research, implements regulations to preserve the Plan's qualification with the Internal Revenue Service, and provides member recordkeeping, accounting and reporting, and receipt and disbursement of Plan assets to eligible members.

Plan Progression

1904	Commercial annuities equal to two-thirds salary for faculty aged 70 or older with 20 years of service.
1924	PRAS pension plan introduced for faculty and high-ranking administrators.
1937	Pension plan coverage established for nonacademic employees through PERS.
1961	PRAS terminated due to insolvency and UCRP established to provide retirement, disability, and pre-retirement survivor benefits to all University career employees.
1971	Annual 2% (maximum) COLAs applied to retirement, survivor, and disability benefits.
1976	Social Security coverage offered to UCRP members.
1990	Employer/employee UCRP contributions suspended.
1991	First voluntary early retirement incentive program offered to eligible UCRP members.
1992	First Capital Accumulation Provision (CAP) allocation credited in behalf of eligible members.

Changes in the Plan

The following Plan changes occurred during fiscal year 1996–97. These changes were mandated by legislation or recommended by the President of the University and approved by The Regents.

All currently effective Plan provisions are contained in the University of California Retirement Plan document.

Date	Change
August 1996 (retroactive to January 1995)	▪ In accordance with federal legislation, repealed the §415(b) average earnings limit, which was equal to 100% of a member's average three highest consecutive years of taxable UC earnings. Annual retirement benefits payable as of January 1995 are now subject only to a general dollar limit (maximum of $125,000 at age 62 in 1997).
January 1997	▪ Revised the age factors used to calculate basic retirement income for retiring members between ages 55 and 59. The new age factors increase in measured increments up to age 60 for members retiring on or after January 1, 1997. ▪ Expanded existing UCRS Board membership provisions to exclude from membership on the UCRS Board University employees who may have a potential conflict of interest in certain policy decisions.
July 1997	▪ Approved comprehensive amendments changing the service credit buyback provisions. The changes apply to members seeking to: 1) establish service credit (a "buyback") for an approved leave; and 2) reestablish service credit for previous UCRP membership for which they received a refund of accumulations. The provisions also affect members who want to eliminate the offset for noncontributory service. All of the following provisions are effective for buyback elections received or approved leaves that begin on or after July 1, 1997. All buyback payments are made on a pretax basis in installments over 1, 2, 3, 4, or 5 years through payroll deduction. For approved leaves, the length of the payment period must be at least as long as the leave. The decision to exercise the buyback option and the length of the payment schedule are irrevocable. The decision to establish service credit for an approved leave or to reestablish service credit for prior UCRP membership must be made within three years from the date the member resumes UC employment. The three-year window does not apply to elections for the noncontributory (plan 02) offset. The amount of service credit that can be purchased for a leave without pay is limited to the first two years of the leave period. This limit does not apply to military leaves, furloughs, temporary layoffs, sabbatical leaves, or extended sick leaves. Members establishing UCRP service credit for an approved leave may not have accrued service credit for the same period in any other publicly funded defined benefit retirement plan. The minimum leave period eligible for buyback is four consecutive weeks (whole periods only). Exceptions may be made for members leaving UC employment who need a shorter period in order to vest. The service credit buyback provisions were initially approved by The Regents in March 1996, with an effective date of July 1, 1996; it was later extended to July 1, 1997.

Employees participate in the Plan in one of four membership classifications:

- Members with Social Security coverage
- Members without Social Security coverage
- Safety Members (police and firefighters)
- Tier Two

At 1997 fiscal year end, UCRP's total membership in all classifications was 122,182. Total membership at June 30, 1997, included 93,404 active members and 28,778 inactive members, of which 13,646 were vested and entitled to retirement benefits but not yet receiving them, and 15,132 who were not vested but were entitled to a refund of their Plan accumulations. The following table reflects Plan membership by classification over the past 10 years.

Plan Membership

	Active Membership						
Fiscal Year End June 30	With Social Security	Without Social Security	Safety Members	Tier Two Members	Total Active	Inactive Members	Total Membership
1997	83,100	9,820	395	89	93,404	28,778	122,182
1996	81,510	10,197	392	95	92,194	25,422	117,616
1995	80,246	10,584	390	98	91,318	21,913	113,231
1994	77,421	11,164	391	101	89,077	18,734	107,811
1993	78,121	13,326	406	108	91,961	16,187	108,148
1992	77,571	14,379	409	120	92,479	15,058	107,537
1991	74,619	15,161	*	*	89,780	17,580	107,360
1990	76,399	18,598	*	*	94,997	6,021	101,018
1989	70,186	19,202	*	*	89,388	5,275	94,663
1988	64,415	19,582	*	*	83,997	4,615	88,612

** Safety and Tier Two members were not counted separately for fiscal years 1988–1991.*

Funding Policy

The Regents' funding policy has been to establish annual contributions as a percentage of payroll by using the entry age normal actuarial funding method and based on designated State appropriations. In fiscal year 1990–91, The Regents adopted a full funding policy. Under that policy, The Regents suspend contributions to the Plan when the market value or the actuarial value of Plan assets (whichever is smaller) exceeds the lesser of the actuarial accrued liability or 150% of current liability plus normal cost.

The University has not made contributions to the Plan since November 1990 due to the Plan's fiscal position and its fully funded status as described in IRC §412. The Regents funding policy is also in line with the University's Department of Energy contract requirements.

UCRP Funding Status

(dollars in millions)

Plan Year Beginning July 1	(a) Actuarial Value of Assets in Excess of AAL	(b) Assets in Excess of Full Funding Liability	(c) Market Value of Assets in Excess of AAL
1997	$3,593.9	$2,932.1	$9,871.8
1996	1,810.6	1,186.8	5,816.9
1995	1,091.5	508.0	3,513.3
1994	1,241.4	719.8	1,001.5
1993	1,305.1	723.6	4,462.3
1992	2,438.6	2,317.9	3,820.2

(a) Beginning July 1, 1994, the Actuarial Value of Assets (AVA) is determined using the Adjusted Market Value Method. Prior to July 1, 1994, AVA is calculated using the Moving Average Market Value Method. The Actuarial Accrued Liability (AAL) is based on the funding method used to value the plan. The AAL is equal to the present value of benefits to be paid less the present value of all future contributions required to finance the Plan.

(b) Assets: The lesser of the Actuarial Value of Assets or the Market Value of Assets. Full Funding Liability: IRC §412, the full funding limitation applied to the Plan, is the lesser of (a) the actuarial accrued liability plus normal cost, or (b) 150% of the current liability plus normal cost.

(c) Market Value of Assets is the June 30, 1997, net asset value.

The Plan paid approximately $573 million in retirement, disability, and preretirement survivor benefits to 29,659 members and their beneficiaries during fiscal year 1996–97.

Retirement payments include cost-of-living adjustments, and payments to survivors include basic death payments. The table below reflects total benefits paid in each category over the past 10 fiscal years.

UCRP Benefit Payments

(dollars in thousands)

Fiscal Year End June 30	Retirement	Disability	Death & Survivor	Total*
1997	$538,125	$14,882	$19,495	$572,502
1996	523,436	13,098	17,711	554,245
1995	529,839	11,789	16,821	558,449
1994	462,891	10,951	16,141	489,983
1993	333,797	10,666	14,819	359,282
1992	283,382	9,541	14,361	307,284
1991	232,516	8,823	12,585	253,924
1990	138,809	8,353	10,224	157,386
1989	119,480	7,959	9,594	137,033
1988	96,102	6,866	8,806	111,774

* *Does not include member withdrawals and lump sum cashouts.*

The number of UCRP benefit recipients in each category as of June 30 for each of the past 10 years is shown below.

UCRP Benefit Recipients

Fiscal Year End June 30	Retired Members	Disabled Members	Deceased Members	Survivors
1997	24,780	1,338	643	3,541
1996	24,365	1,203	569	3,350
1995	24,230	1,081	573	3,130
1994	23,301	1,024	596	2,919
1993	18,873	993	559	2,732
1992	16,606	961	600	3,074
1991	16,237	931	542	2,605
1990	10,986	850	527	2,194
1989	10,632	885	502	2,206
1988	9,648	859	491	2,086

Investments

Investment Management

In a defined benefit plan such as UCRP, the employer/plan sponsor has a contractual obligation to pay promised benefits, with or without the necessary assets segregated in a trust fund. The employer bears the mortality and investment risk because members' benefits are not based on contributions or Plan assets. As Plan Trustees, The Regents are responsible for the investment of the Plan's assets, consistent with fiduciary laws of the State of California. The Treasurer of The Regents is the investment manager and custodian for the Plan's assets. The Treasurer's function is executed under the policies established by the Regents' Committee on Investments to protect the interests of all Plan members and their beneficiaries.

The assets of the Plan are held separately under a custodial agreement with State Street Bank & Trust Co. The bank carries insurance against loss of property caused by employee dishonesty, theft, misplacement, damage, distribution, or mysterious disappearance.

Proxy Voting Policy

The following summarizes Regents' policy on proxy voting.

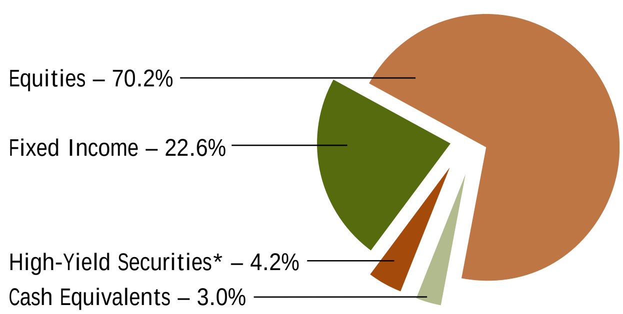
The Regents, as shareholder, have instructed the Treasurer to vote with management recommendations on most proxy issues that are of a routine business management nature. When the proxy issue is controversial or relates to social matters, it is submitted by the Treasurer to be voted upon by all members of the Board of Regents.

Total Investment Return

The Regents are committed to achieving a long-term total return that meets the Plan's benefit obligations to its members and beneficiaries. In executing investment policy, the Treasurer looks to maximize real, long-term total returns (income plus capital appreciation, adjusted for inflation), while assuming appropriate levels of risk.

Asset Allocation

Total Fund. The bulk of the $28.8 billion investment portfolio is invested in common stocks of multi-national companies. The balance includes alternative equities, high-yield securities, and investments in high-quality government, corporate, and foreign bonds, and cash equivalents.



* *Includes electric utility common stock and convertible bonds.*

Historical Investment Performance

Total Rate of Return Comparisons at June 30

Fiscal Year End	UCRP	SEI Linked Median	S&P 500*	Lehman G / C / Y	Inflation*
1997	25.8%	21.4%	34.7%	7.9%	2.3%
1996	21.2	16.0	26.1	4.7	2.8
1995	26.2	17.0	26.0	12.8	3.0
1994	(2.8)	0.8	1.3	(1.5)	2.5
1993	17.1	14.0	13.6	13.2	3.0
1992	15.3	13.2	13.5	14.2	3.1
1991	9.3	9.0	7.4	10.2	4.7
1990	13.7	11.1	16.4	7.1	4.7
1989	16.8	14.5	20.5	12.3	5.2
1988	(7.4)	0.2	(6.9)	7.5	3.9
Compound Annualized Rates	13.0%	11.6%	14.6%	8.7%	3.5%
Cumulative Rates	238.9%	199.8%	291.9%	131.2%	41.2%
Standard Deviation	11.2%	6.5%	12.4%	4.8%	1.0%

SEI Linked Median – The SEI Linked Median is the compounded return of the balanced fund median of quarterly samples over a given period of time. It is based on investment returns from 3,149 pension portfolios with assets aggregating more than $364 billion as compiled by SEI Capital Resources of SEI Corp.

Standard & Poor's 500 – A broad-based, market value weighted measurement of 400 industrial company stocks, 20 transportation stocks, 40 financial company stocks, and 40 public utilities.

Lehman Government / Corporate / Yankee Bond Index (Lehman G / C / Y) – A market value weighted index of intermediate and long-term domestic government and investment grade coprorate debt securities comprised of approximately 75% government obligations and 25% corporate and Yankee bonds.

Inflation – The Consumer Price Index for all Urban Customers (CPI-U), not seasonally adjusted, used to measure the rate of change of consumer goods prices.

Standard Deviation – The standard deviation of an index is a measure of its volatility. For asset returns, it is a measure of risk.

* *Source: ©Stocks, Bonds, Bills, and Inflation 1997 Yearbook™ Ibbotson Associates, Chicago (annually updates work by Roger G. Ibbotson and Rex A. Sinquefield). Used with permission. All rights reserved. Rates of return provided through Ibbotson Associates monthly updates as of June 30, 1997.*

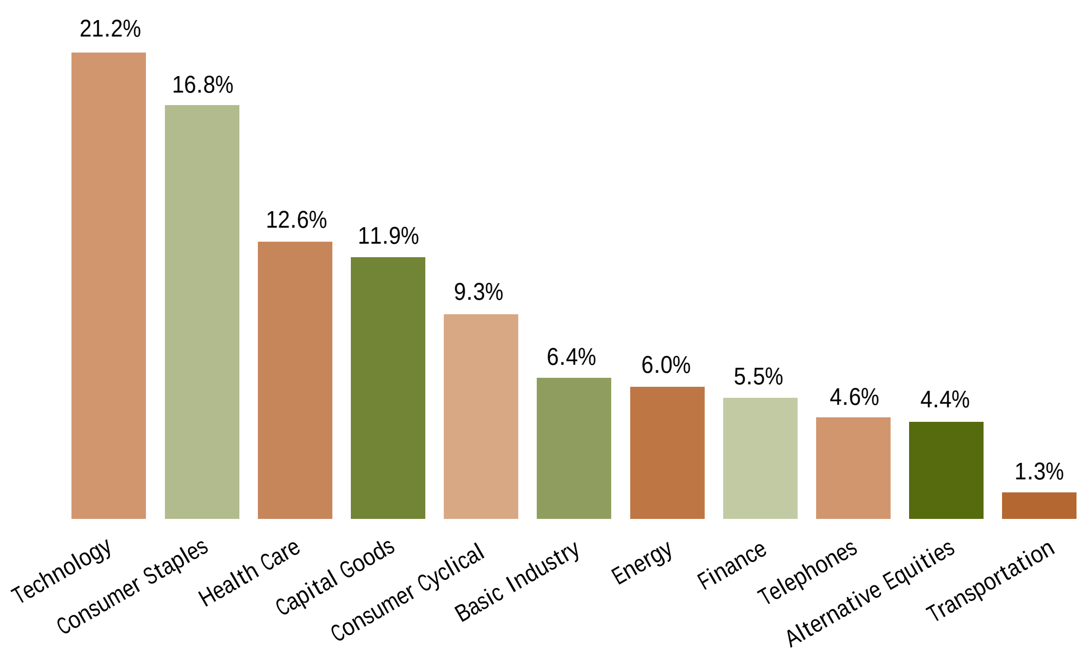
Equity Portfolio

Quality and Diversification. The equity portfolio accounts for approximately 70% of the total Fund and is invested primarily in high-quality, global common stocks. Investments in foreign securities are currently a small but growing portion of the common stock investments and include ADRs (U.S. dollar-denominated foreign stocks) and emerging market funds.

Investments in alternative equities and registered investment companies account for approximately 3% of the total Fund.

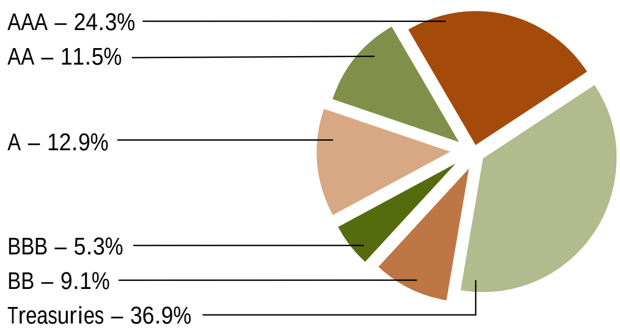
The equity portfolio is diversified among multiple strategic economic sectors. The five largest sector holdings are: technology, consumer staples, health care, capital goods, and consumer cyclical. (See chart.)

Equity Portfolio Diversification by Economic Sector

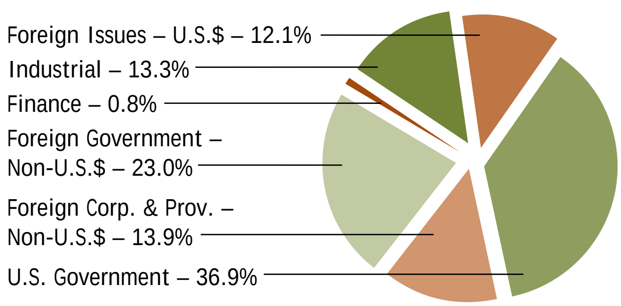


Fixed Income Portfolio

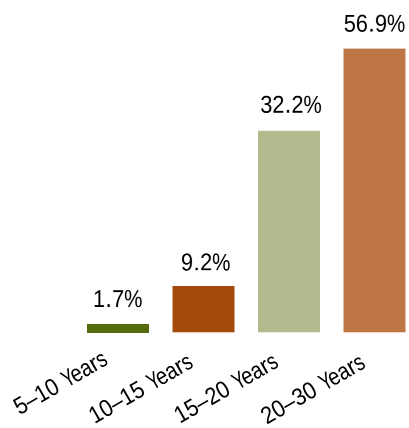
Quality. The fixed income portfolio accounts for approximately 23% of the total Fund and is invested primarily in high-quality, call-protected, global bonds with long-term maturities. Approximately 37% of the portfolio consists of U.S. government-guaranteed securities, and 36% of the portfolio is rated AAA or AA, the two highest rankings assigned by Standard and Poor's.



Diversification. Fixed income investments are diversified among the following sectors: approximately 37% in U.S. Treasury securities, 14% in high-grade industrials and finance, 12% in U.S. dollar-denominated foreign issues, and 14% in foreign government and corporate bonds. Of the U.S. government holdings, approximately 30% consists of zero-coupon bonds, the majority of which are in U.S. Treasury STRIPS.



Maturity Structure. Consistent with the long-term investment objectives of the Plan, approximately 89% of the fixed income portfolio is invested in bonds with maturities of 15 to 30 years. Although this makes the portfolio more sensitive to interest rates, long-term bonds generally offer higher yields and have historically produced greater total returns.



Treasury Obligations: Guaranteed by the full faith and credit of the United States and rated AAA by Standard & Poor's.

Standard & Poor's Bond Ratings—

AAA: Highest quality. Extremely strong capacity to pay principal and interest.

AA: High quality. Very strong capacity to pay principal and interest.

A: Upper medium investment grade. Strong capacity to pay principal and interest.

BBB: Medium investment grade. Adequate capacity to pay principal and interest.

BB: Speculative characteristics. Exposure to adverse conditions could impair current ability to pay principal and interest.

Health and Welfare Benefit Coverages

Tax-qualified non-pension employee benefits are covered under various IRC sections and state statutes, which set forth coverage, definitions, and funding rules. Health and welfare benefit coverage is not a funding obligation of UCRP, nor can these benefits be paid from the UCRP trust fund.
As part of the annual state budget, the University receives appropriations toward the cost of plan premiums that parallel appropriations to other similarly situated state agencies. These programs are currently provided to approximately 96,400 employees and to 33,400 annuitants and family members of both groups.

In contrast to the pension liability, which has long been identified as a University contractual obligation and has been funded at levels adequate to ensure future payment of benefits, the University's liability for both current and postretirement health and welfare benefits is limited to its annual appropriation from the state.

If The Regents were to create and operate an actuarially sound postretirement health care plan, thereby separating the University from The Public Employees Medical and Hospital Care Act under Government Code §22751 et seq., the accrued liability would amount to $3.1 billion under accounting standards set by the Financial Accounting Standards Board (FASB) Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* FASB Statement No. 106 provides that health care and other postretirement benefits of current and future retirees are considered deferred compensation. These benefits are considered earned during a member's period of service and accrued during each year worked and discounted to a present value. The present value of postretirement benefits is based on age and years of service.

Medical Plans

The University's medical plans were authorized and funding established by state statute and Regental resolution in 1961. The statute, as frequently amended, sets forth provisions, definitions, and contribution rules applicable to all state employees whose medical plan coverage is financed by the state's general revenues and is therefore subject to the annual appropriation process. In 1997, employees and annuitants each received an aggregate $2,719, which covered the full cost for 65.1% of the covered population (including family members). Approximately 45,300 employees and annuitants have coverage under a medical plan that requires cost-sharing. The current University contribution covers the total premium for the lowest cost health maintenance organization (HMO) plan, which provides at least one completely University-paid medical plan at each location.

Annual Medical Plan Premium Expense

(dollars in thousands)

Year	University Contribution*	Employee/ Annuitant Contribution	Total Premium Cost
1997	$352,934	$23,751	$376,685
1996	344,461	29,824	374,285
1995	363,381	22,595	385,976

* *Maximum employer contribution for all medical plans. For 1997: $1,608 single; $3,300 two-party; $4,476 family. The University contribution shown above does not include its contribution for Medicare Part B premiums, which exceeded $7 million in 1997.*

Medical Plan Coverage – 5-year Enrollments

Year	Total Covered Employees, Annuitants & Family Members
1997	275,700
1996	276,300
1995	275,200
1994	271,200
1993	269,200

Enrollment by Type of Medical Plan

	Employees	Annuitants	Total*
Fee-for-service & Preferred Provider	5,600	9,700	15,300
Point of Service	26,000	8,000	34,000
HMOs	64,900	15,500	80,400

** Does not include employees/annuitants in medical plans for Medicare enrollees.*

Other Health and Welfare Plan Coverage

In addition to medical plan coverage, the University contributes toward the cost of dental, vision, short-term disability, and life insurance benefits for all eligible employees. For dental care, employees can choose coverage under one of two plans that provide preventive, basic, prosthetic, and orthodontic dental benefits. Coverage under the vision plan includes routine eye examinations and corrective lenses. University-paid disability insurance pays a temporary income to any eligible employee who incurs a short-term disability. Benefits paid through this plan equal a percentage of the employee's base salary up to a maximum of $800 per month for up to six months. Lastly, in accordance with IRC §79, the University maintains a group term life policy that provides basic life insurance coverage equal to one times an employee's annual base salary, up to a maximum of $50,000.

Employees may also purchase additional disability and life insurance coverage, and they have the option to enroll in a legal expense insurance plan and an accidental death and dismemberment plan at their own expense. A flexible spending account for child care expenses is also available.

During 1997, the University's contribution toward the cost of plan premiums to provide coverage to eligible employees under these other health and welfare plans exceeded $95 million.

Other Health and Welfare Plan Coverage – 1997 Enrollments

	Total Covered Employees	Total Covered Annuitants	Total University-Paid Premiums
Dental Care	88,100	32,400	$71.2 million
Vision Care	88,600	**	$11.1 million
Disability Insurance	90,900	**	$ 7.9 million
Term Life Insurance	103,300	**	$ 5.4 million

*** University-paid vision, disability insurance, and term-life insurance coverages cannot be continued into retirement.*

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INDEPENDENT AUDITOR'S REPORT

Board of Regents
University of California
Oakland, California

We have audited the accompanying statements of plan net assets of the University of California Retirement Plan (Plan) as of June 30, 1997 and 1996, and the related statements 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 audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits 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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial status of the Plan as of June 30, 1997 and 1996, and the changes in its financial status for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 1 to the financial statements, the Plan adopted Statement No. 25 of the Governmental Accounting Standards Board, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosure for Defined Contribution Plans* and Statement No. 28 of the Government Accounting Standards Board, *Accounting for Securities Lending Transactions in 1997*.

Or audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The other supplemental schedules are not a required part of the financial statements. These schedules are the responsibility of the Plan's management. The required supplementary information for the fiscal years ended June 30, 1996 and 1997, has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole. The required supplementary information for other fiscal years presented was audited by other auditors.

Deloitte & Touche LLP

October 6, 1997

Financial Statements

Statements of Plan Net Assets

($ in thousands)

June 30	1997	1996
Assets		
Investments, at fair value:		
Pooled investments	$ 853,062	$ 196,562
Common stocks	20,108,570	17,846,263
Alternative equities	385,952	360,276
Registered investment companies	379,332	227,103
Fixed income	7,100,882	4,921,337
Investment of cash collateral	2,570,411	
Total Investments	31,398,209	23,551,541
Receivables:		
Contributions	108,090	110,147
Interest and dividends	122,470	96,564
Securities sales and other	88,443	51,076
Total Receivables	319,003	257,787
Total Assets	31,717,212	23,809,328
Liabilities		
Payable for securities purchased	4,436	46,610
Member withdrawals, refunds, and other payables	16,975	20,713
Securities collateral payable under securities lending agreements	2,567,321	
Total Liabilities	2,588,732	67,323
Net Assets Held in Trust for Pension Benefits*	$29,128,480	$23,742,005

** See Required Supplementary Schedule of Funding Progress.*

See Notes to Financial Statements.

Statements of Changes in Plan Net Assets

($ in thousands)

For the years ended June 30	1997	1996
Additions		
Contributions:		
State of California	$ 182	$ 208
Contracts, grants, and other	176	123
Members	2,491	2,081
Total Contributions	2,849	2,412
Investment Income:		
Net appreciation in fair value of investments and foreign currency exchange contracts	5,162,606	3,434,938
Interest, dividends, and other investment income	994,958	779,141
Less investment expenses	(132,329)	
Total Investment Income	6,025,235	4,214,079
Interest Income from State of California Note	8,911	9,088
Total Additions	6,036,995	4,225,579
Deductions		
Benefit payments:		
Retirement payments	473,917	466,633
Member withdrawals	15,259	14,981
Cost-of-living adjustments	64,208	56,803
Lump sum cashouts	50,242	30,122
Pre-retirement survivor payments	13,865	12,890
Disability payments	14,882	13,098
Death payments	5,630	4,821
Total Benefit Payments	638,003	599,348
Expenses:		
Plan administration	12,357	13,575
VERIP administration		40
Other	160	214
Total Expenses	12,517	13,829
Total Deductions	650,520	613,177
Increase in Net Assets Held in Trust for Pension Benefits	5,386,475	3,612,402
Net Asssets Held in Trust for Pension Benefits		
Beginning of Year	23,742,005	20,129,603
End of Year	$29,128,480	$23,742,005

See Notes to Financial Statements.

Notes To Financial Statements

Fiscal Years ended June 30, 1997 and 1996

Note 1 – Description of the Plan and Significant Accounting Policies

General. The University of California Retirement Plan (the Plan) is a defined benefit plan providing lifetime retirement income, disability protection, death benefits, and pre-retirement survivor benefits to eligible employees of the University of California (the University) and its affiliates. Established in 1961, membership in the Plan is required for all employees appointed to work at least 50% time for a year or more. Generally, five years of service are required for entitlement to Plan benefits. The amount of the pension benefit is determined by salary rate, age, and years of service credit. An offset formula is used for Social Security members. The maximum monthly benefit is 100% of the employee's highest average compensation over a 36-month period, adjusted for annual Internal Revenue Code (IRC) §415 limitations. Cost-of-living adjustments (COLAs) are tied to the Consumer Price Index (CPI), according to and limited by a specified formula. Periodic ad hoc COLA adjustments are subject to funding availability.

The Plan also includes three Voluntary Early Retirement Incentive Programs (VERIPs) adopted by The Regents of the University of California (The Regents), which offered enhanced benefits to certain eligible members upon electing early retirement. The VERIPs are known as *Plus 5* (fiscal year 1991–1992), *Take 5* (fiscal year 1992–1993), and *VERIP III* (fiscal year 1993–1994).

Members' contributions are accounted for separately and accrue interest at 6% per annum, credited monthly. Upon termination, members may elect a refund of their contributions plus accumulated interest; vested terminated members who are eligible to retire may also elect a lump sum payment equal to the present value of their accrued benefits. Both actions thereby forfeit the member's rights to further accrued benefits.

Plan members may also have a balance in the Plan consisting of Capital Accumulation Provision (CAP) allocations, which were credited in behalf of eligible members on various dates in 1992, 1993, and 1994. Provided to supplement basic UCRP benefits, the allocations were equal to a percentage of the eligible member's covered compensation paid during the specified period. The CAP balance is generally payable in a lump sum at retirement or separation from service and includes interest credited monthly at an annual rate of 8.5%.

Effective July 1, 1987, Plan members could elect to participate in Tier Two (noncontributory Plan membership), provided the member had at least six month's membership in the Plan. Tier Two provides a lower level of retirement income, disability protection, and survivor benefits, calculated using specific Tier Two formulas based on the member's salary rate, age, and years of service credit. A member's election to participate in Tier Two is irrevocable and will apply for all subsequent periods of University employment that are not separated by a break in service. Effective July 1, 1990, Tier Two was closed to further membership.

At June 30, 1997, Plan membership consisted of 29,659 retirees and beneficiaries currently receiving benefits, 13,646 terminated vested employees entitled to benefits but not yet receiving them, and 15,132 terminated nonvested employees entitled to a refund of their Plan accumulations. Of current employees, 59,431 are fully vested and 33,973 are nonvested active employees covered by the Plan.

Employee and employer contributions are made to the Plan in behalf of all members. The rate of employer contributions is established annually pursuant to Regents' funding policy (see Note 3), as a percentage of covered wages, recommended and certified by an enrolled, independent actuary, and approved by The Regents, the Plan's trustee.

Use of Estimates in the Preparation of Financial Statements. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of net assets available for benefits at the date of the financial statements and the reported amounts of changes in net assets available for benefits during the reporting period. Actual results could differ from those estimates.

Basis of Accounting. The financial statements have been prepared on the accrual basis of accounting.

Financial Reporting. The financial statements have been prepared in accordance with generally accepted accounting principles, as outlined in Governmental Accounting Standards Board (GASB) Statement No. 25. Certain recently issued GASB Statements (including GASB No. 25) have been adopted by the Plan, as described below. Where applicable, the Statements have been applied retroactively.

GASB No. 25, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosures for Defined Contribution Plans,* was adopted by the Plan on July 1, 1996. GASB No. 25 establishes reporting and disclosure standards for defined benefit pension plans and for pension trust funds included in the financial reports of plan sponsors. GASB No. 25 supercedes all previous financial reporting standards allowed for governmental defined benefit plans including GASB No. 5, *Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers,* and Financial Accounting Standards Board Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* previously relied upon by the Plan. GASB No. 25 requires a statement of plan net assets, a statement of changes in plan net assets, investments be carried at fair value with unrealized gains and losses included in the statement of changes in plan net assets, and certain footnote disclosures regarding actuarial methods, contribution requirements, and funding progress of the Plan. The effect of such adoption was not significant to the Plan.

GASB No. 28, *Accounting and Financial Reporting for Securities Lending Transactions,* was adopted by the Plan on July 1, 1996. GASB No. 28 establishes accounting and financial reporting standards for securities lending transactions and requires the Plan to record cash and certain securities received as collateral under securities lending transactions as assets, and liabilities resulting from these transactions in the statement of plan net assets. Revenues from and costs of securities lending transactions, such as borrower rebates and agent fees, are reported as investment income and expenditures, respectively, in the statement of changes in plan net assets.

Valuation of Investments. Investments are reported at fair value. Securities listed on a stock exchange are valued at the last sale price on the last business day of the fiscal year. Securities not listed on any stock exchange and securities for which no sale was reported as of the close of trading of the principal exchange are valued at the last sale price within five days of the last business day of the fiscal year or at the quoted price of a dealer who regularly trades in the security being valued.

Debt securities are valued based on yields currently available on comparable securities of issuers with similar credit ratings.

Interests in alternative equities and venture capital partnerships are valued based upon the valuations determined by the general partners of the respective partnerships. Securities received as distributions from the venture capital partnerships are valued in accordance with the valuation methods described above for such securities.

Investments in registered investment companies are valued based upon the net asset value (NAV) per share of the companies. The NAV is determined by adding the value of all portfolio holdings and other assets, subtracting the liabilities, and dividing the result by the total number of shares outstanding. Values of the portfolio holdings are reported at quoted market prices or, in the absence of quoted prices, at amounts representing estimates of fair values using methods determined by the directors of the companies.

Mortgage loans are valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments.

Accounting for Investments. Investment transactions are accounted for on the date the securities are purchased or sold (trade date). Dividend income is recorded on ex-dividend date, and interest income is accrued as earned.

Administrative Expenses. Administrative expenses are incurred in connection with the operation of the Plan for items such as staff salaries and benefits, information systems, leased space, supplies and equipment, and professional services rendered by the Plan actuary, legal counsel, and independent auditor. Included in expenses for fiscal years 1997 and 1996 were investment management fees totaling approximately $2.3 million for each year, paid to the Office of the Treasurer of the University of California (the Treasurer). Administrative expenses for the fiscal year ended June 30, 1996 included approximately $40,000 in nonrecurring charges related to administering the Voluntary Early Retirement Incentive Programs. Total Plan administrative expenses represent approximately $12.4 million or 0.04% and $13.6 million or 0.06%, respectively, of the net assets held in trust for pension benefits for fiscal years 1997 and 1996.

Income Tax Status. The Internal Revenue Service has determined and informed the University by letter dated January 9, 1997, that the Plan and related trust are designed and operated in accordance with applicable sections of the IRC of 1986, as amended, applicable to governmental defined benefit pension plans. The Plan has been amended since receiving the determination letter. However, the Plan Administrator and the Plan's tax counsel believe that the Plan is designed and is currently being operated in compliance with the applicable requirements of the IRC, and is therefore qualified under §401(a) and the related trust tax exemption under §501(a).

Reclassification. Certain amounts in 1996 have been reclassified to conform with the 1997 financial statement presentation.

Note 2 – Investments and Securities Lending Transactions

Pooled investments of $853,062,000 and $196,562,000 in 1997 and 1996, respectively, represent amounts held in the Plan's general operating accounts with the Treasurer. These monies are pooled with the monies of other University agencies and invested by the Treasurer in the Short-Term Investment Pool. These assets are not required to be categorized by GASB No. 3, as they are not individually identifiable.

The Plan's remaining investments are categorized as Risk Category 1, the lowest risk, which is defined by GASB No. 3 as insured or registered or securities held by the Plan or its agent in the Plan's name. For the years ended June 30, 1997 and 1996, State Street Bank and Trust was the master custodian for the majority of the investments of the Plan. There are no individual investments in excess of 5% of the net assets held in trust for pension benefits at June 30, 1997 and 1996.

The Plan participates in a securities lending program as a means to augment income. Securities are lent to select brokerage firms for which collateral is received in excess of the market value of such investments during the period of the loan. Collateral may be cash or securities issued by the U.S. Government or its agencies, or the sovereign or provincial debt of foreign countries. Securities held as collateral cannot be pledged or sold by the Plan unless the borrower defaults. Loans of domestic equities and all fixed income securities are initially collateralized at 102% of the fair value of securities lent. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls less than 100% of the fair value of securities lent. The Plan receives interest and dividends during the loan period, as well as a fee from the brokerage firm. Securities on loan for cash collateral are not considered to be categorized. At June 30, 1997, the Plan had no credit risk exposure to borrowers because the amounts the Plan owes the borrowers exceed the amounts the borrowers owe the Plan. The Plan is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the Plan or the borrower. Cash collateral is invested by the Plan's lending agent, as an agent for the Plan, in the Short-Term Investment Pool in the Plan's name, with guidelines approved by the Treasurer. At June 30, 1997, the securities in this pool had weighted average maturity of 47 days.

Securities Lending Transactions *($ in thousands)*

	Investments					
	Owned Not Lent	Lent for Cash Collateral	Lent for Securities Collateral	Total Owned	Investment of Cash Collateral	Total
Corporate equity securities	$19,732,498	$ 365,247	$ 10,825	$20,108,570		$20,108,570
U.S. and state gov't obligations	646,869	1,723,859	35,376	2,406,104	$ 46,072	2,452,176
Corporate debt securities	1,422,962	72,861		1,495,823	1,240,660	2,736,483
Foreign debt securities:						
US $ denominations	715,478	74,528		790,006		790,006
Foreign currency denominations	2,053,801		355,148	2,408,949	1,003,152	3,412,101
Alternative equities and						
Registered investment cos.	765,284			765,284		765,284
Pooled investments	853,062			853,062	280,527	1,133,589
	$26,189,954	$2,236,495	$401,349	$28,827,798	$2,570,411	$31,398,209

The Plan's investment portfolio includes certain foreign denominated securities. To reduce the exposure to foreign currency fluctuations inherent in such investments, the Plan may enter into foreign currency forward contracts and options. Under the Plan's investment policies, such instruments are not permitted for speculative use or to create leverage.

At June 30, 1997, the Plan had net unrealized gain of $3.7 million on outstanding forward commitments to sell $125,879,000 in foreign currency with contracts maturing through September 25, 1997. Any gains or losses at contract maturity are offset by gains or losses on the currency in the Plan's portfolio of foreign securities.

Net appreciation (depreciation) in fair value of investments and foreign currency exchange contracts includes both realized and unrealized gains and losses on investments. The calculation of realized gains and losses is independent of the calculation of net appreciation (depreciation) in the fair value of Plan assets held at fiscal year end. Unrealized gains and losses on investments and foreign currency exchange contracts sold in the current year that had been held for more than one year include the net appreciation (depreciation) reported in the prior years.

Net Appreciation in Fair Value of Investments	1997	1996
Unrealized Appreciation (Depreciation)		
Common stocks, alternative equities,		
and registered investment companies	$2,600,417	$2,998,078
Fixed income	525,040	(23,523)
Mortgage loans		79
Foreign currency exchange contracts	2,561	1,299
Pooled investments	144	4,718
Investment of cash collateral	3,091	
Total	$3,131,253	$2,980,651
Realized Gains		
Sales of securities	$2,031,353	$ 454,287
Net Appreciation	$5,162,606	$3,434,938

($ in thousands)

Unrealized Appreciation (Depreciation) in Fair Value of Investments	1997	1996
Investments at fair value as determined by quoted market price:		
Common stocks	$2,542,001	$2,915,294
Registered investment companies	(49,127)	20,064
Fixed income	525,040	(23,523)
Pooled investments	144	4,718
Investment of cash collateral	3,091	
Investments at estimated fair value:		
Mortgage loans		79
Alternative equities	107,543	62,720
Foreign currency exchange contracts	2,561	1,299
Total	$3,131,253	$2,980,651

($ in thousands)

Note 3 – Contributions and Reserves

Actuarially Determined Contribution Requirements and Contributions Made. The Regents' funding policy provides for actuarially determined periodic contributions at rates that provide for sufficient assets to be available when benefits are due, measured in line with the minimum contribution requirements set forth in IRC §412. The contribution rate is determined using the entry age normal actuarial funding method. The entry age normal funding method has been utilized since 1975 as the fundamental basis for the valuation of retirement benefits.

Under this method, the actuarial present value of the projected benefits of each individual included in an actuarial valuation is allocated on a level basis over the earnings of the individual between entry age and assumed exit age(s). The portion of this actuarial present value allocated to a valuation year is called the normal cost. The portion of this actuarial present value not provided for at a valuation date by the actuarial present value of future normal costs is called the actuarial accrued liability. Under this method, the actuarial gains (losses), as they occur, reduce (increase) the unfunded actuarial accrued liability. Under the current funding policy, the Plan is fully funded at June 30, 1997 and 1996.

As of June 30, 1997, the differences between the net assets held in trust for pension benefits presented in the Statements of Plan Net Assets and the net assets allocated to fund actuarial accrued liability (shown on page 27) was as follows:

($ in millions)

	1997
Net Plan Assets Held in Trust for Pension Benefits	$29,128.5
Less:	
Difference between smoothed market value, used for the actuarial valuation, and fair value, used for financial statement presentation	6,277.6
Net assets allocated to fund the actuarial accrued liability	$22,850.9

The above amounts are not considered available by Plan management for purposes of calculating the net assets allocated to fund the actuarially determined accrued liability.

The effect of the Voluntary Early Retirement Incentive Programs on the actuarial accrued liability at June 30, 1997, was as follows:

($ in millions)

	1997
Actuarial value of assets in excess of actuarial accrued liability without VERIPs	$4,639.2
Less unfunded actuarial liability of the VERIPs:	
Plus 5 (fiscal year 1991–1992)	210.5
Take 5 (fiscal year 1992–1993)	137.8
VERIP III (fiscal year 1993–1994)	697.0
Actuarial value of assets in excess of actuarial accrued liability with VERIPs – entry age normal cost basis	$3,593.9

Mandatory employee contributions, made as a condition of employment, are based upon covered University wages less a specified monthly reduction, determined periodically by The Regents, currently as shown below:

Member Assessment

	Members Without Social Security	Members With Social Security		Safety Members	
Effective:		Below Wage Base	Above Wage Base		Monthly Reduction
07/01/93	3.0%*	2.0%	4.0%	3.0%*	$19
11/01/90	4.5%	2.0%	4.0%	8.0%	$19
06/30/90	6.0%	2.0%	4.0%	8.0%	$19

** The entire member assessment was directed to the Defined Contribution Plan during fiscal year 1996–97.*

At June 30, 1997 and 1996, member accumulations of current employees, including allocated investment income, in the Plan amounted to approximately $769.8 million and $755.6 million, respectively.

The annually determined rates for employer contributions as a percentage of payroll are based on recommendations of the consulting actuary and any pension appropriations received from the State of California, and in conformance with the full funding definitions set forth in IRC §412.

Employer contributions, if any, are credited as a percentage of covered University pay. The recommended employer contributions when combined with member contributions are intended to accumulate sufficient assets to fund the actuarial accrued liability under entry age normal cost method in order to pay accumulated Plan benefits to vested members.

Employer Assessment

Effective:	Members With Social Security, Members Without Social Security, and Tier Two Members	Safety Members
11/01/90	0.00%	0.00%
01/01/90	4.03	3.77

Accumulated Plan benefits are those future benefit payments that are attributable under the Plan's provisions to the service employees have rendered. Accumulated Plan benefits include benefits expected to be paid to (a) retired or terminated members or their beneficiaries, (b) beneficiaries of deceased members, and (c) present members or their beneficiaries.

Accumulated Plan benefits are based on members' compensation histories and years of service rendered as of the valuation date of June 30, 1997 and 1996.

Note 4 – Contributions Receivable

Contributions receivable includes $105.9 million and $108.3 million at June 30, 1997 and 1996, respectively, related to agreements with the State of California (the State). In 1984, the State agreed to pay contributions to the Plan of $66.5 million in 30 annual installments of approximately $5.9 million, including interest at 8%, based on the discount rate used in the 1984 actuarial valuation. Similarly, in fiscal year 1990, the State agreed to pay contributions to the Plan of $57.2 million in 30 annual installments of approximately $5.3 million, including interest at 8.46%, based on the discount rate used in the 1990 actuarial valuation.

Note 5 – Plan Termination

The Regents intend and expect to continue the Plan indefinitely, but reserve the right to amend or discontinue the Plan at any time provided that any such action shall not lessen accrued benefits. In the event that the Plan is terminated, its assets shall be applied solely for the benefit of retired, vested or active participants and beneficiaries, until all liabilities of the Plan have been satisfied.

Once all liabilities have been satisfied, any excess assets shall revert to The Regents as the Plan's Trustee. Neither The Regents as Trustee nor the University carry termination insurance for the Plan, as the Plan is not subject to ERISA Title IV provisions, nor is it overseen by the Pension Benefit Guaranty Corporation.

Analysis of dollar amounts of the actuarial value of assets available for benefits, actuarial accrued liability, and actuarial value of assets in excess of the actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets available for benefits as a percentage of the actuarial accrued liability provides one indication of the funding status on a going-concern basis. Analysis of this percentage over time indicates whether the Plan is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the Plan. Trends in the unfunded actuarial accrued liability or assets in excess of the actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability or assets in excess of the actuarial accrued liability as a percentage of annual covered payroll generally adjusts for the effects of inflation and aids in the analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the plan.

Required Supplementary Schedule of Funding Progress *($ in millions)*

Fiscal years ended June 30

Actuarial Valuation Date	(1) Actuarial Value of Assets Available for Benefits*	(2) Actuarial Accrued Liability	(3) Total Actuarial Surplus (2) – (1)	(4) Funded Ratio (1) ÷ (2)	(5) Annual Covered Payroll	(6) Actuarial Surplus as a Percentage of Annual Covered Payroll (3) ÷ (5)
6/30/97	$22,850.9	$19,257.0	$(3,593.9)	118.7%	$4,762.3	(75.5%)
6/30/96	19,735.6	17,925.1	(1,810.6)	110.1%	4,500.1	(40.2%)
6/30/95	17,707.8	16,616.3	(1,091.5)	106.6%	4,262.3	(25.6%)
6/30/94	16,512.5	15,271.2	(1,241.4)	108.1%	3,888.1	(31.9%)
6/30/93	15,132.6	13,827.4	(1,305.1)	109.4%	4,104.8	(31.8%)
6/30/92	14,007.4	11,568.7	(2,438.6)	121.1%	3,927.0	(62.1%)

* *For fiscal year 1994 and earlier, this is the average ratio of market value to historical cost value determined at the end of each quarter for the last 20 quarters, times historical cost. For fiscal year 1995 and later, the actuarial value of assets is based on a smoothing method that reflects the expected market value plus amortization of investment gains and losses over five years.*

Required Schedule of Employer Contributions. For fiscal years 1992 through 1997, the University has not been required to make contributions to the Plan (other than contributions required for service credit buyback) due to the fully funded status of the Plan.

Note to Required Supplementary Information

Actuarial Information

The required supplementary information was determined as part of the actuarial valuation as of the date indicated. Additional information as of the most recent actuarial valuation is as follows:

	Valuation Date – Fiscal Year Ended June 30, 1997
Additional Trend Information	
Actuarial cost method	Entry Age
Amortization method	Level percent open
Remaining amortization period	3.11 Years
Asset valuation method	5-year smoothed market
Actuarial assumptions	
Investment rate of return*	7.50%
Projected salary increases*	4.5–6.5%
Cost-of-living adjustments	2.00%

** Includes inflation at 4% for fiscal year 1996–97.*

The actuarial assumptions are based on the presumption that the Plan will continue in operation. Were the Plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated Plan benefits.

Other Supplementary Information

The total actuarial accrued liability of the Plan, calculated using the entry age normal cost method, was $19,257 million at June 30, 1997. This liability is then compared against the actuarial value of Plan assets to determine the annual required contribution to fund the Plan.

Actuarial Accrued Liability *($ in millions)*

	1997
Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits	$7,862
Current employees:	
Accumulated employee contributions, including allocated investment earnings	770
Employer-financed vested	10,010
Employer-financed nonvested	615
Total actuarial accrued liability – entry age normal cost basis	19,257
Net assets allocated to fund the actuarial accrued liability, at smoothed market value	22,851
Actuarial value of assets in excess of actuarial accrued liability – entry age normal cost basis	$3,594

Other Supplementary Information

Revenues by Source and Expenses by Type

Revenues by Source

($ in thousands)

Fiscal Year	Member Contributions*	Employer Contributions*	Investment & Other Income**	Total
1997	$ 2,491	$ 358	$2,902,893	$2,905,742
1996	2,081	331	1,242,516	1,244,928
1995	2,436	407	999,291	1,002,134
1994	6,232	483	1,305,483	1,312,198
1993	14,239	603	993,228	1,008,070
1992	13,198	529	820,617	834,344
1991	42,078	47,460	1,018,551	1,108,089
1990	87,484	162,479	1,211,818	1,461,781
1989	80,229	211,498	684,615	976,342
1988	71,911	257,531	652,628	982,070

Expenses by Type

($ in thousands)

Fiscal Year	Benefits	Administrative & Other Expenses	Member Withdrawals, Transfers & Other Activity	Total
1997	$622,744	$12,517	$15,259	$650,520
1996	584,367	13,829	14,981	613,177
1995	587,552	17,492	22,979***	628,023
1994	511,351	23,078	35,656***	570,085
1993	376,543	22,274	19,652***	418,469
1992	307,451	18,463	5,718	331,632
1991	253,925	18,571	7,131	279,627
1990	157,386	12,491	8,746	178,623
1989	137,032	10,683	7,281	154,996
1988	111,774	11,841	8,400	132,015

* *The decrease in member contributions since fiscal year 1991 reflects the direction of all or a portion of UCRP member contributions to the Defined Contribution Plan. The decrease in employer contributions reflects the zero University contribution rate. Both of these changes became effective November 1, 1990.*

** *This includes investment income, realized gain or loss on the sales of investments, and miscellaneous income. It does not include unrealized gains or losses in the value of assets.*

*** *The increase in member withdrawals reflects Capital Accumulation Provision (CAP) payments to members who elected early retirement under the VERIPs.*

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INDEPENDENT AUDITOR'S REPORT

Board of Regents
University of California
Oakland, California

We have audited the accompanying statements of plan net assets of the University of California PERS Voluntary Early Retirement Incentive Program Plan (Plan) as of June 30, 1997 and 1996, and the related statements 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 audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits 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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial status of the Plan as of June 30, 1997 and 1996, and the changes in its financial status for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 1 to the financial statements, the Plan adopted Statement No. 25 of the Governmental Accounting Standards Board, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosure for Defined Contribution Plans* in 1997.

Or audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The other supplemental schedules are not a required part of the financial statements. These schedules are the responsibility of the Plan's management. The required supplementary information for the fiscal years ended June 30, 1996 and 1997, has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole. The required supplementary information for other fiscal years presented was audited by other auditors.

Deloitte & Touche LLP

October 6, 1997

Deloitte Touche
Tohmatsu
International

Financial Statements – University of California PERS

Voluntary Early Retirement Incentive Program

Statements of Plan Net Assets

($ in thousands)

June 30	1997	1996
Assets		
Pooled investments, at fair value	$63,805	$52,962
Total Assets	63,805	52,962
Liabilities		
Other	54	54
Total Liabilities	54	54
Net Assets Held in Trust for Pension Benefits	$63,751	$52,908

See Notes to Financial Statements

Statements of Changes in Plan Net Assets

($ in thousands)

Years Ended June 30	1997	1996
Additions		
Contributions		$ 2,732
Investment income	$15,535	9,554
Total Additions	15,535	12,286
Deductions		
Retirement payments	4,692	4,731
Increase in Net Assets Held in Trust for Pension Benefits	10,843	7,555
Net Assets Held in Trust for Pension Benefits:		
Beginning of Year	52,908	45,353
End of Year	$63,751	$52,908

See Notes to Financial Statements.

Notes To Financial Statements – University of California PERS

Fiscal Years ended June 30, 1997 and 1996

Note 1 – Description of the Plan and Significant Accounting Policies

General. The University of California PERS Voluntary Early Retirement Incentive Program (the Plan) is a defined benefit pension plan providing lifetime supplemental retirement income and survivor benefits to UC-PERS members who elected early retirement under the provisions of the Plan. The University of California contributed to the California Public Employees' Retirement System (PERS) in behalf of these UC-PERS members.

Generally, to become a participant under the Plan, an eligible employee had to elect concurrent retirement under PERS and the Plan effective October 1, 1991; must have had Plan Age plus Plan Service Credit equal to 80 years as of September 30, 1991, if classified as a Qualified Academic Senate Faculty Member, or, equal to 75 years if not classified as a Qualified Academic Senate Faculty Member. Of 1,579 eligible employees, 879 elected to retire under this voluntary early retirement incentive program.

The cost of contributions made to the Plan is borne entirely by the University and the Department of Energy (DOE) laboratories. Over the five-year period ended June 30, 1996, the University and DOE laboratories were required to make contributions to the Plan as determined by the Plan actuary sufficient to maintain the promised benefits and the qualified status of the Plan under the regulations of the Internal Revenue Code of 1986 (IRC).

Use of Estimates in the Preparation of Financial Statements. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of net assets available for benefits at the date of the financial statements and the reported amounts of changes in net assets available for benefits during the reporting period. Actual results could differ from those estimates.

Basis of Accounting. The financial statements have been prepared on the accrual basis of accounting.

Financial Reporting. The financial statements have been prepared in accordance with generally accepted accounting principles, as outlined in Governmental Accounting Standards Board (GASB) Statement No. 25. Certain recently issued GASB Statements (including GASB No. 25) have been adopted by the Plan, as described below. Where applicable, the Statements have been applied retroactively.

GASB No. 25, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosures for Defined Contribution Plans,* was adopted by the Plan on July 1, 1996. GASB No. 25 establishes reporting and disclosure standards for defined benefit pension plans and for pension trust funds included in the financial reports of plan sponsors. GASB No. 25 supercedes all previous financial reporting standards allowed for governmental defined benefit plans including GASB No. 5, *Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers,* and Financial Accounting Standards Board Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* previously relied upon by the Plan. GASB No. 25 requires a statement of plan net assets, a statement of changes in plan net assets, investments be carried at fair value with unrealized gains and losses included in the statement of changes in plan net assets, and certain footnote disclosures regarding actuarial methods, contribution requirements, and funding progress of the Plan. The effect of such adoption was not significant to the Plan.

GASB No. 28, *Accounting and Financial Reporting for Securities Lending Transactions,* was adopted by the Plan on July 1, 1996. GASB No. 28 establishes accounting and financial reporting standards for securities lending transactions and requires the Plan to record cash and certain securities received as collateral under securities lending transactions as assets, and liabilities resulting from these transactions in the statement of plan net assets. Revenues from and costs of securities lending transactions, such as borrower rebates and agent fees, are reported as investment income and expenditures, respectively, in the statement of changes in plan net assets.

Valuation of Investments. The assets of the Plan are combined for investment purposes with the assets of the University of California Retirement Plan (UCRP). Accordingly, the assets of the Plan are valued based on a pooled interest of the combined investments. The two plans are separate trusts, and for the purposes of fund and plan accounting, each plan is accounted for on a separate basis.

Investments are reported at fair value. Securities listed on a stock exchange are valued at the last sale price on the last business day of the fiscal year. Securities not listed on any stock exchange and securities for which no sale was reported as of the close of trading are valued at the last sale price within five days of the last business day of the fiscal year or at the quoted price of a dealer who regularly trades in the security being valued.

Debt securities are valued based on yields currently available on comparable securities of issuers with similar credit ratings.

Interests in alternative equities and venture capital partnerships are valued based upon the valuations determined by the general partners of the respective partnerships. Securities received as distributions from the venture capital partnerships are valued in accordance with the valuation methods described above for securities.

Investments in registered investment companies are valued based upon the net asset value (NAV) per share of the companies. The NAV is determined by adding the value of all portfolio holdings and other assets, subtracting the liabilities, and dividing the result by the total number of shares outstanding. Values of the portfolio holdings are reported at quoted market prices or, in the absence of quoted prices, at amounts representing estimates of fair values using methods determined by the directors of the companies.

Mortgage loans are valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments.

Accounting for Investments. Investment transactions are accounted for on the date the securities are purchased or sold (trade date). Dividend income is recorded on ex-dividend date, and interest income is accrued as earned.

Administrative Expenses. Administrative expenses of the Plan are paid by UCRP net of an annual account servicing charge of $10 per participant.

Income Tax Status. The Plan is intended to qualify under the statutory requirements of the Internal Revenue Code of 1986, as amended, applicable to governmental defined benefit pension plans. The Plan's tax counsel believes that the Plan as currently designed and operated is in compliance with applicable requirements of the 401(a) and the related trust tax exemption under Section 501(a).

Note 2 – Investments

The Plan's investments of $63,805,000 are included within the UCRP investment pool. These monies are pooled with the monies of the University of California and invested by the Treasurer in the Short-Term Investment Pool. These assets are not required to be categorized by GASB No. 3, as they are not individually identifiable.

Note 3 – Contributions and Reserves

Actuarially Determined Contribution Requirements and Contributions. The Regents' funding policy provides for actuarially determined lump sum or periodic contributions to be made by the Office of the President, campuses, and DOE laboratories in behalf of Plan participants at rates that provide for sufficient assets to be available when benefits are due. The campuses and DOE laboratories were given the option of funding their contribution in a lump sum, over three years, or over five years.

Accumulated Plan benefits are those future benefit payments that are attributable under the Plan's provisions to the service employees have rendered. Accumulated Plan benefits include benefits expected to be paid to (a) retired or terminated members or their beneficiaries, (b) beneficiaries of deceased members, and (c) present members or their beneficiaries.

The actuarial assumptions are based on the presumption that the Plan will continue in operation. Were the Plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated Plan benefits.

Note 4 – Plan Termination

The Regents intend and expect to continue the Plan indefinitely, but reserve the right to amend the Plan at any time provided that any such action shall not lessen accrued benefits. In the event that the Plan is terminated, Plan assets shall be applied solely for the benefit of retired, vested, or active participants and beneficiaries, until all liabilities of the Plan have been satisfied.

In the event Plan assets available for benefits are insufficient to meet its obligations, The Regents' funding policy provides for additional contributions to be made in behalf of Plan participants by the Office of the President, campuses, and DOE laboratories.

Once all liabilities have been satisfied, any excess assets shall revert to The Regents as the Plan's Trustee. Neither The Regents as Trustee nor the University carry termination insurance for the Plan, as the Plan is not subject to ERISA Title IV provisions, nor is it overseen by the Pension Benefit Guaranty Corporation.

Required Supplementary Information

Analysis of dollar amounts of the actuarial value of assets available for benefits, actuarial accrued liability, and actuarial value of assets in excess of the actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets available for benefits as a percentage of the actuarial accrued liability provides one indication of the funding status on a going-concern basis. Analysis of this percentage over time indicates whether the Plan is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the Plan. Trends in the unfunded actuarial accrued liability or assets in excess of the actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability or assets in excess of the actuarial accrued liability as a percentage of annual covered payroll generally adjusts for the effects of inflation and aids in the analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the plan.

Required Supplementary Schedule of Funding Progress

($ in thousands)

Fiscal years ended June 30

Actuarial Valuation Date	(1) Actuarial Value of Assets Available for Benefits*	(2) Actuarial Accrued Liability	(3) Total Actuarial Liability (Surplus) (2) – (1)	(4) Funded Ratio (1) ÷ (2)
6/30/97	$63,751	$46,792	$(16,959)	136.2%
6/30/96	52,908	46,783	(6,125)	113.1%
6/30/95	45,353	47,565	2,212	95.3%
6/30/94	37,759	49,025	11,266	77.0%
6/30/93	37,489	46,567	9,078	80.5%
6/30/92	26,817	45,833	19,016	58.5%

* *Reported at fair value.*

Because 100% of the members in the Plan are retired, there is no annual covered payroll.

Required Supplementary Schedule of Employer Contributions

($ in thousands)

Fiscal years ended June 30	Employer Contributions: Annual Required Contribution	Employer Contributions: Contribution Percentage
1997	$ 0	100%
1996	2,732	100
1995	2,732	100
1994	6,336	100
1993	10,285	100
1992	42,264	100

Note to Required Supplementary Information

Actuarial Information

The required supplementary information was determined as part of the actuarial valuation as of the date indicated. Additional information as of the most recent actuarial valuation is as follows:

	Valuation Date – Fiscal Year Ended June 30, 1997
Additional Trend Information	
Actuarial cost method	Unit Credit
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Market
Actuarial assumptions	
Investment rate of return*	7.50%
Projected salary increases	N/A
Cost-of-living adjustments	None

** Includes inflation at 4% for fiscal year 1996–97.*

The actuarial assumptions are based on the presumption that the Plan will continue in operation. Were the Plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated Plan benefits.

Other Supplementary Information

The total net assets available in excess of the total actuarial accrued liability (AAL) of the Plan based on the standardized measure of the AAL, which uses the entry age normal cost basis, as appears in the actuarial valuation, was approximately $16,959,000 at June 30, 1997, as follows:

Actuarial Accrued Liability *($ in millions)*

	1997
Retirees and beneficiaries currently receiving benefits	$46.8
Total actuarial accrued liability – entry age normal cost basis	46.8
Net assets allocated to fund the actuarial accrued liability, at smoothed market value	63.8
Actuarial value of assets in excess of the actuarial accrued liability – entry age normal cost basis	$17.0

Plan Trustees – Appointed Regents of the University of California

UCRS Advisory Board

Member	Location	Term
Duncan A. Mellichamp (Chair)	UC Santa Barbara	July 1992–June 2000
Julia Armstrong	UC Santa Cruz	October 1994–June 2001
Stephen Barclay	UC San Francisco	July 1996–June 2000
Robert H. Drake	Los Alamos National Lab	July 1995–June 1999
Patricia E. Erickson	Lawrence Livermore National Lab	July 1996–June 2000
Cheryl F. Hagen	UC Riverside	July 1994–June 1998
V. Wayne Kennedy	Office of the President	July 1994–June 1998
Patricia A. Small	Office of the Treasurer	Permanent
Steve Sugarman	UC Berkeley	July 1994–June 1998

None of the Regents or UCRS Board members received any compensation from the Plan for services rendered during fiscal year 1997–96.

Investment Management

Treasurer	Patricia A. Small

Plan Administration

Plan Administrator	Richard C. Atkinson
Senior Vice President	V. Wayne Kennedy
Interim UCRS Assistant Vice President	James F. Sullivan
UCRS Internal Counsel	Dorothy E. Dana
UCRS Retirement and Savings Plans	Judy F. Ackerhalt
UCRS Health and Welfare Plans	Michele E. French
UCRS Claims Administration and Customer Service	Susan C. Mathews
UCRS Controller	David L. Olson
UCRS Communications	Barbara J. Facey
UCRS Systems	Myrna Walton

Plan Actuary	Towers Perrin
Plan Auditor	Deloitte & Touche LLP
Plan Counsel	O'Melveny & Myers