

Financial Statements

**KENTUCKY RETIREMENT SYSTEMS**

June 30, 2003 and 2002

# KENTUCKY RETIREMENT SYSTEMS

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June 30, 2003 and 2002

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## INDEPENDENT AUDITOR'S REPORT

Board of Trustees  
Kentucky Retirement Systems  
Frankfort, Kentucky

We have audited the financial statements of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the Kentucky Retirement Systems' management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Kentucky Retirement Systems as of and for the year ended June 30, 2002 were audited by other auditors whose report dated October 31, 2002, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of June 30, 2003 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, 2003 on our consideration of the Kentucky Retirement Systems' 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.

Management's Discussion and Analysis (pages 2 through 6) and the supplementary information included in the schedule of funding progress and schedule of employer contributions (pages 31 through 42) are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The additional supporting schedules (pages 44 through 46) are presented for the purpose of additional analysis and are not a required part of the financial statements. Such information 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.

September 18, 2003  
Louisville, Kentucky

## **KENTUCKY RETIREMENT SYSTEMS**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

June 30, 2003 and 2002

This discussion and analysis of Kentucky Retirement Systems' financial performance provides an overview of the pension fund's and insurance fund's financial activities for the fiscal year ended June 30, 2003. Please read it in conjunction with the Pension Fund's financial statements and Insurance Fund's financial statements, which begin on page 7.

#### **FINANCIAL HIGHLIGHTS--PENSION FUND**

The following highlights are explained in more detail later in this discussion.

- The combined plan net assets of all pension funds administered by Kentucky Retirement Systems increased by \$5.5 million during the 2002-2003 fiscal year.
- Covered payroll for 2002-2003 was \$4 billion compared to covered payroll for the 2001-2002 plan year of \$3.8 billion, an increase of \$228 million. The corresponding employer contributions decreased by \$16.5 million for a total employer contribution amount of \$277 million. Of the total employer contribution amount, \$43.7 million was posted to the pension fund while \$233.3 million was posted to the insurance fund. Contributions paid by employees were \$314.8 and \$286.8 million respectively for the years ended June 30, 2003 and June 30, 2002. This increase in employee contributions is a reflection of the increase in covered payroll.
- The net appreciation in the fair value of investments was \$110 million for the year ended June 30, 2003 compared to net depreciation of \$868.6 million for the prior fiscal year. Included in this net appreciation were realized losses on sales of investments of \$155.2 million. In comparison, the pension funds realized losses of \$664.3 million for the year ended June 30, 2002. The net realized loss experienced by the pension funds is due to unfavorable market conditions.
- Investment income net of investment expense from all sources including securities lending was \$321 million representing a decline in investment income of approximately \$49.6 million compared to last fiscal year. This decline is due to unfavorable market conditions.
- Pension benefits paid to retirees and beneficiaries increased \$108.1 million bringing total benefit payments to \$749 million. Refund of contributions paid to former members upon termination of employment increased from \$18 million to \$20.5 million.
- Administrative expense increased \$1.8 million totaling \$14.4 million compared to \$12.6 million in the prior year.

#### **FINANCIAL HIGHLIGHTS--INSURANCE FUND**

- The following highlights are explained in more detail later in this discussion.
- The combined plan net assets of the insurance fund administered by Kentucky Retirement Systems increased by \$147.4 million during the 2002-2003 fiscal year.
- Employer contributions of \$233.4 million were received. This is a decrease of \$33.9 million over the prior fiscal year. This decrease is due to four of the five systems having a decrease in the insurance transfer percentage rate.
- The net appreciation in the fair value of investments was \$6.3 million compared to depreciation of \$73 million for the prior fiscal year. The insurance fund realized net loss on sale of investments of \$24.8 million. This loss is due to unfavorable market conditions.
- Investment income net of investment expense from all sources including securities lending was \$22 million representing an increase of approximately \$1.8 million compared to last fiscal year.
- Premiums paid by the fund for hospital and medical insurance coverage increased \$17.2 million to total \$113.3 million for the year.

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## KENTUCKY RETIREMENT SYSTEMS

### MANAGEMENT'S DISCUSSION AND ANALYSIS--CONTINUED

June 30, 2003 and 2002

#### USING THIS FINANCIAL REPORT

Because of the long-term nature of a defined benefit pension plan and post-employment healthcare benefit plan, financial statements alone cannot provide sufficient information to properly reflect the plan's ongoing plan perspective. This financial report consists of two financial statements and two required schedules of historical trend information. The Combined Statements of Plan Net Assets and Combined Statements of Changes in Plan Net Assets (pages 7 and 8) provide information about the activities of the pension funds and insurance fund as a whole. Kentucky Retirement Systems is the fiduciary of funds held in trust for five distinct groups of members. The Combining Statements of Plan Net Assets and Combining Statements of Changes in Plan Net Assets (pages 9 through 12) provide more detailed information about each plan assets, liabilities, plan net assets, and changes in plan net assets.

The Schedule of Funding Progress (pages 31 through 36) 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 and insurance premiums when due. The Schedule of Employer Contributions (pages 37 through 42) presents historical trend information about the annual required contributions of employers and the contributions made by employers in relation to the requirement. These schedules provide information that contributes to understanding the changes over time in the funded status of the plans.

#### KENTUCKY RETIREMENT SYSTEMS AS A WHOLE

Kentucky Retirement Systems' combined plan net assets increased during the year ended June 30, 2003 by \$152.9 million from \$12,104.4 million to \$12,257.3 million. Plan net assets for the prior fiscal year decreased by \$737.3 million. The increase in plan net assets for the plan year ended June 30, 2003 is attributable to the change in market conditions. The analysis below focuses on plan net assets (Table 1) and changes in plan net assets (Table 2) of Kentucky Retirement Systems' pension funds and insurance fund.

**Table 1**  
**Plan Net Assets**  
**(In Millions)**

	Pension Funds			Insurance Fund			Total		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
Cash & Investments	\$14,240.2	\$13,492.8	\$13,420.1	\$1,664.2	\$1,372.5	\$1,156.7	\$15,904.4	\$14,865.3	\$14,576.8
Receivables	124.9	132.0	125.0	25.2	29.6	21.2	150.1	161.6	146.2
Equipment, net of depreciation	1.0	1.2	0.0	0.0	0.0	0.0	1.0	1.2	0.0
<b>Total Assets</b>	<u>\$14,366.1</u>	<u>\$13,626.0</u>	<u>\$13,545.1</u>	<u>\$1,689.4</u>	<u>\$1,402.1</u>	<u>\$1,177.9</u>	<u>\$16,055.5</u>	<u>\$15,028.1</u>	<u>\$14,723.0</u>
<b>Total Liabilities</b>	<u>\$(3,452.5)</u>	<u>\$(2,718.0)</u>	<u>\$(1,781.9)</u>	<u>\$(345.7)</u>	<u>\$(205.7)</u>	<u>\$(99.4)</u>	<u>\$(3,798.2)</u>	<u>\$(2,923.7)</u>	<u>\$(1,881.3)</u>
<b>Plan Net Assets</b>	<u>\$10,913.6</u>	<u>\$10,908.0</u>	<u>\$11,763.2</u>	<u>\$1,343.7</u>	<u>\$1,196.4</u>	<u>\$1,078.5</u>	<u>\$12,257.3</u>	<u>\$12,104.4</u>	<u>\$12,841.7</u>

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## KENTUCKY RETIREMENT SYSTEMS

### MANAGEMENT'S DISCUSSION AND ANALYSIS--CONTINUED

June 30, 2003 and 2002

**Table 2**  
**Changes in Plan Net Assets**  
**(In Millions)**

	Pension Funds			Insurance Fund			Total		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
<b>Additions:</b>									
Member Cont.	\$ 314.8	\$ 286.8	\$ 250.2	\$ 0.0	\$ 0.0	\$ 0.0	\$ 314.8	\$ 286.8	\$ 250.2
Employer Cont.	43.7	26.3	105.5	233.4	267.3	182.6	277.1	293.6	288.1
Invest. Inc. (net)	<u>430.9</u>	<u>(498.0)</u>	<u>(698.5)</u>	<u>28.2</u>	<u>(52.5)</u>	<u>(40.7)</u>	<u>459.1</u>	<u>(550.5)</u>	<u>(739.2)</u>
<b>Total additions</b>	<u>\$ 789.4</u>	<u>\$(184.9)</u>	<u>\$(342.8)</u>	<u>\$261.6</u>	<u>\$214.8</u>	<u>\$141.9</u>	<u>\$1,051.0</u>	<u>\$ 29.9</u>	<u>\$(200.9)</u>
<b>Deductions:</b>									
Benefit payments	\$ 749.0	\$ 640.9	\$ 548.5	\$ 0.0	\$ 0.0	\$ 0.0	\$ 749.0	\$ 640.9	\$ 548.5
Refunds	20.5	17.9	18.6	0.0	0.0	0.0	20.5	17.9	18.6
Administrative Expense	14.4	12.6	10.9	0.9	0.8	0.7	15.3	13.4	11.6
Healthcare Premiums	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>113.3</u>	<u>96.1</u>	<u>81.9</u>	<u>113.3</u>	<u>96.1</u>	<u>81.9</u>
<b>Total deductions</b>	<u>\$ 783.9</u>	<u>\$ 671.4</u>	<u>\$ 578.0</u>	<u>\$114.2</u>	<u>\$ 96.9</u>	<u>\$ 82.6</u>	<u>\$ 898.1</u>	<u>\$ 768.3</u>	<u>\$ 660.6</u>
<b>Increase (decrease)</b>									
<b>in plan net assets</b>	<u>\$ 5.5</u>	<u>\$(856.3)</u>	<u>\$(920.8)</u>	<u>\$147.4</u>	<u>\$117.9</u>	<u>\$ 59.3</u>	<u>\$ 152.9</u>	<u>\$(738.4)</u>	<u>\$(861.5)</u>

Plan net assets of the pension funds increased by \$5.5 million (\$10,913.6 million compared to \$10,908.0 million). All of these assets are restricted in use to provide monthly retirement allowances to members who contributed to the pension funds as employees and their beneficiaries. This plan net asset increase is attributable primarily to the net appreciation in the fair value of investments due to the change in market conditions in general.

Plan net assets of the insurance fund increased by \$147.4 million (\$1,343.7 million compared to \$1,196.4 million). All of these assets are restricted in use to provide hospital and medical insurance benefits to members of the pension funds who receive a monthly retirement allowance. This increase in net plan assets is primarily attributable to the net appreciation in the fair value of investments which is due to the change in market conditions in general.

### PENSION FUND ACTIVITIES

Member contributions increased by \$28 million. Retirement contributions are calculated by applying a percentage factor to salary and are remitted by each employer on behalf of the member. Members may also pay contributions to repurchase previously refunded service credit or to purchase various types of elective service credit. During the year there was an increase in monthly contributions over the previous year due to the increase in salaries reported to Kentucky Retirement Systems. The amount of elective service purchases also increased this fiscal year.

Employer contributions decreased (\$16.5 million). Even though salaries reported to Kentucky Retirement Systems increased (\$228 million), employer contributions decreased due to the reduction in the employer rate applied to covered payroll.

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## KENTUCKY RETIREMENT SYSTEMS

### MANAGEMENT'S DISCUSSION AND ANALYSIS--CONTINUED

June 30, 2003 and 2002

Net investment income increased by \$928.9 million (income of \$431 million compared to loss of \$498 million in the prior year). The pension funds experienced an increase in income primarily due to the appreciation in the fair value of investments. This can be illustrated as follows:

	<u>In Millions</u>
Appreciation in fair value of investments-June 30, 2003	\$ 477.7
Appreciation in fair value of investments-June 30, 2002	<u>212.5</u>
Net appreciation in fair value of investments	265.2
Investment income (net of investment expense)	321.0
Net loss on sale of investments	<u>(155.2)</u>
Investment income (net)-June 30, 2003	<u>\$ 431.0</u>

Program deductions increased by \$112.6 million caused principally by an increase of \$108.1 million in benefit payments. Retirees received an increase of 2.85% in benefits as of July 1, 2002. Also there was an increase of approximately 1900 members and beneficiaries on the retired payroll as of June 30, 2003. Refunds of member contributions increased by \$2.6 million.

### INSURANCE FUND ACTIVITIES

Employer contributions paid into the insurance fund decreased by \$33.9 million over the prior year. While covered payroll actually increased by \$228 million, four of the five systems experienced a decrease in rate applied to covered payroll.

Net investment income increased from a net loss of \$52.4 million in the prior year to net income of \$28.2 million this year. This increase in net income is due to the increase in net appreciation in the fair value of assets. This can be illustrated as follows:

	<u>In Millions</u>
Appreciation in fair value of investments-June 30, 2003	\$ 11.2
Appreciation in fair value of investments-June 30, 2002	<u>(19.8)</u>
Net appreciation in fair value of investments	31.0
Investment income (net of investment expense)	22.0
Net loss on sale of investments	<u>(24.8)</u>
Investment Income (net)-June 30, 2003	<u>\$ 28.2</u>

The increase in program deductions is due to the increase in payment of healthcare premiums of \$17.2 million.

### HISTORICAL TRENDS

Accounting standards require that the statement of plan net assets state asset value at **fair value** and include only benefits and refunds due plan members and beneficiaries and accrued investment and administrative expense as of the reporting date. Information regarding the actuarial funding status of the pension funds and insurance fund is provided in the Schedule of Funding Progress (pages 31 through 36). The asset value stated in the Schedule of Funding Progress is the **actuarial value** of assets determined by calculating the difference between the expected valuation assets and the actual market value of assets adjusted for any unrecognized gains or losses and amortized over a five year period. The actuarial accrued liability is calculated using the entry age normal cost funding method.

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## **KENTUCKY RETIREMENT SYSTEMS**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS--CONTINUED**

June 30, 2003 and 2002

The funding position of the pension funds continues to provide more than adequate assets to meet pension obligations. The insurance fund continues to have a large unfunded liability of all participating employees groups. However, the funded ratio for all employee groups participating in the pension funds and the insurance fund show a positive trend over the six-year period displayed.

Annual required contributions of the employers and contributions made by the employers in relation to the required contributions are provided in the Schedule of Employer Contributions (pages 37 through 42). This schedule indicates that employers are generally meeting their responsibilities to provide resources to the plans.



## KENTUCKY RETIREMENT SYSTEMS

### COMBINED STATEMENTS OF PLAN NET ASSETS

June 30, 2003 and 2002

(Dollars in Thousands)

	2003			2002		
	Pension	Post- Employment Healthcare	Total	Pension (Restated)	Post- Employment Healthcare	Total (Restated)
<b>ASSETS</b>						
<b>Cash and Short-Term Investments</b>						
Cash	\$ 1,493	\$ 216	\$ 1,709	\$ 28,494	\$ 24,939	\$ 53,433
Short-term investments	<u>485,752</u>	<u>147,010</u>	<u>632,762</u>	<u>548,058</u>	<u>142,009</u>	<u>690,067</u>
<b>Total cash and short-term investments</b>	<b>487,245</b>	<b>147,226</b>	<b>634,471</b>	<b>576,552</b>	<b>166,948</b>	<b>743,500</b>
<b>Receivables</b>						
Investments - accounts receivable	480	63	543	720	70	790
Interest receivable - year end	59,102	3,371	62,473	70,486	3,027	73,513
Accounts receivable - year end	62,139	21,790	83,929	57,008	26,494	83,502
Accounts receivable - alternate plan	2,970	-	2,970	3,551	-	3,551
Accounts receivable - alternate plan - year end	<u>187</u>	<u>-</u>	<u>187</u>	<u>244</u>	<u>-</u>	<u>244</u>
<b>Total receivables</b>	<b>124,878</b>	<b>25,224</b>	<b>150,102</b>	<b>132,009</b>	<b>29,591</b>	<b>161,600</b>
<b>Investments, at fair value</b>						
Corporate and government bonds	3,845,290	133,241	3,978,531	3,680,675	119,766	3,800,441
Corporate stocks	5,886,202	1,039,366	6,925,568	5,861,831	881,263	6,743,094
Mortgages	560,005	-	560,005	642,520	-	642,520
Real estate	<u>17,256</u>	<u>-</u>	<u>17,256</u>	<u>21,699</u>	<u>-</u>	<u>21,699</u>
<b>Total investments</b>	<b>10,308,753</b>	<b>1,172,607</b>	<b>11,481,360</b>	<b>10,206,725</b>	<b>1,001,029</b>	<b>11,207,754</b>
<b>Securities lending collateral invested</b>	<b>3,444,164</b>	<b>344,416</b>	<b>3,788,580</b>	<b>2,709,530</b>	<b>204,493</b>	<b>2,914,023</b>
<b>Equipment (net of accumulated depreciation)</b>	<b><u>1,012</u></b>	<b><u>-</u></b>	<b><u>1,012</u></b>	<b><u>1,199</u></b>	<b><u>-</u></b>	<b><u>1,199</u></b>
<b>Total Assets</b>	<b><u>14,366,052</u></b>	<b><u>1,689,473</u></b>	<b><u>16,055,525</u></b>	<b><u>13,626,015</u></b>	<b><u>1,402,061</u></b>	<b><u>15,028,076</u></b>
<b>LIABILITIES</b>						
Accounts payable	8,340	1,258	9,598	8,446	1,193	9,639
Securities lending collateral obligations	<u>3,444,164</u>	<u>344,416</u>	<u>3,788,580</u>	<u>2,709,530</u>	<u>204,493</u>	<u>2,914,023</u>
<b>Total Liabilities</b>	<b><u>3,452,504</u></b>	<b><u>345,674</u></b>	<b><u>3,798,178</u></b>	<b><u>2,717,976</u></b>	<b><u>205,686</u></b>	<b><u>2,923,662</u></b>
<b>Plan Net Assets Held in Trust for Plan Benefits</b>	<b><u>\$ 10,913,548</u></b>	<b><u>\$ 1,343,799</u></b>	<b><u>\$ 12,257,347</u></b>	<b><u>\$ 10,908,039</u></b>	<b><u>\$ 1,196,375</u></b>	<b><u>\$ 12,104,414</u></b>

(A schedule of funding progress for each plan is presented on pages 31-36)

See accompanying independent auditor's report and notes to financial statements

## KENTUCKY RETIREMENT SYSTEMS

### COMBINED STATEMENTS OF CHANGES IN PLAN NET ASSETS

Years Ended June 30, 2003 and 2002  
(Dollars in Thousands)

	2003			2002		
	Pension	Post- Employment Healthcare	Total	Pension (Restated)	Post- Employment Healthcare	Total (Restated)
<b>ADDITIONS</b>						
Members' contributions	\$ 314,855	\$ -	\$ 314,855	\$ 286,822	\$ -	\$ 286,822
Employers' contributions	43,661	233,351	277,012	26,260	267,260	293,520
<b>Total contributions</b>	358,516	233,351	591,867	313,082	267,260	580,342
<b>Investment Income</b>						
From investing activities						
Net appreciation (depreciation) in fair value of investments	109,972	6,272	116,244	(868,579)	(134,227)	(1,002,806)
Demutualization proceeds	-	-	-	-	61,603	61,603
Interest	228,942	7,141	236,083	240,540	13,147	253,687
Dividends	97,317	15,164	112,481	130,801	7,149	137,950
<b>Total investing activities income (loss)</b>	436,231	28,577	464,808	(497,238)	(52,328)	(549,566)
<b>Investment expense</b>	7,385	522	7,907	7,295	451	7,746
<b>Commissions</b>	3,101	378	3,479	3,990	430	4,420
<b>Total investing activities expense</b>	10,486	900	11,386	11,285	881	12,166
<b>Net income (loss) from investing activities</b>	425,745	27,677	453,422	(508,523)	(53,209)	(561,732)
<b>From Securities Lending Activities</b>						
Securities lending income	35,925	2,980	38,905	60,496	4,242	64,738
Securities lending expense:						
Security borrower rebate	29,191	2,286	31,477	47,021	3,325	50,346
Security lending agent fee	1,554	140	1,694	2,964	186	3,150
<b>Net income from securities lending activities</b>	5,180	554	5,734	10,511	731	11,242
<b>Total net investment income (loss)</b>	430,925	28,231	459,156	(498,012)	(52,478)	(550,490)
<b>Total Additions</b>	789,441	261,582	1,051,023	(184,930)	214,782	29,852

	2003			2002		
	Pension	Post-Employment Healthcare	Total	Pension (Restated)	Post-Employment Healthcare	Total (Restated)
<b>DEDUCTIONS</b>						
Benefit payments	\$ 748,980	\$ -	\$ 748,980	\$ 640,859	\$ -	\$ 640,859
Refunds	20,522	-	20,522	17,918	-	17,918
Administrative expenses	14,430	862	15,292	12,603	778	13,381
Healthcare premiums paid	-	113,296	113,296	-	96,104	96,104
<b>Total deductions</b>	<u>783,932</u>	<u>114,158</u>	<u>898,090</u>	<u>671,380</u>	<u>96,882</u>	<u>768,262</u>
<b>Net increase (decrease) in plan assets</b>	5,509	147,424	152,933	(856,310)	117,900	(738,410)
<b>Plan Net Assets Held in Trust for Plan Benefits</b>						
<b>Beginning of Year (as previously reported for 2002)</b>	10,908,039	1,196,375	12,104,414	11,763,201	1,078,475	12,841,676
<b>Adjustment for Change in Accounting Method</b>	-	-	-	1,148	-	1,148
<b>Beginning of Year (as restated for 2002)</b>	<u>10,908,039</u>	<u>1,196,375</u>	<u>12,104,414</u>	<u>11,764,349</u>	<u>1,078,475</u>	<u>12,842,824</u>
<b>End of Year (as restated for 2002)</b>	<u>\$ 10,913,548</u>	<u>\$ 1,343,799</u>	<u>\$ 12,257,347</u>	<u>\$ 10,908,039</u>	<u>\$ 1,196,375</u>	<u>\$ 12,104,414</u>

See accompanying independent auditor's report and notes to financial statements

## KENTUCKY RETIREMENT SYSTEMS

### COMBINING STATEMENTS OF PLAN NET ASSETS--PENSION FUNDS

June 30, 2003 and 2002

(Dollars in Thousands)

ASSETS	KERS	KERS	CERS	CERS	State	2003	2002 Total
	<u>Hazardous</u>	<u>Non-Hazardous</u>	<u>Hazardous</u>	<u>Non-Hazardous</u>	<u>Police</u>	<u>Total</u>	<u>(Restated)</u>
<b>Cash and short-term investments</b>							
Cash	\$ 139	\$ 386	\$ 218	\$ 615	\$ 135	\$ 1,493	\$ 28,494
Short-term investments	<u>18,057</u>	<u>152,861</u>	<u>68,395</u>	<u>238,154</u>	<u>8,285</u>	<u>485,752</u>	<u>548,058</u>
<b>Total cash and short-term investments</b>	18,196	153,247	68,613	238,769	8,420	487,245	576,552
<b>Receivables</b>							
Investments - accounts receivable	16	165	64	225	10	480	720
Interest receivable - year end	1,642	27,079	6,180	22,424	1,777	59,102	70,486
Accounts receivable - year end	3,036	28,459	8,194	21,426	1,024	62,139	57,008
Accounts receivable - alternate plan	-	-	1,673	1,297	-	2,970	3,551
Accounts receivable-alternate plan-year end	<u>-</u>	<u>-</u>	<u>122</u>	<u>65</u>	<u>-</u>	<u>187</u>	<u>244</u>
<b>Total receivables</b>	4,694	55,703	16,233	45,437	2,811	124,878	132,009
<b>Investments, at fair value</b>							
Corporate and government bonds	104,852	1,772,037	398,907	1,452,706	116,788	3,845,290	3,680,675
Corporate stocks	175,804	2,686,554	624,404	2,226,016	173,424	5,886,202	5,861,831
Mortgages	15,234	257,881	58,421	211,499	16,970	560,005	642,520
Real estate	<u>1,994</u>	<u>6,641</u>	<u>3,055</u>	<u>4,742</u>	<u>824</u>	<u>17,256</u>	<u>21,699</u>
<b>Total investments at fair value</b>	297,884	4,723,113	1,084,787	3,894,963	308,006	10,308,753	10,206,725
<b>Securities lending collateral invested</b>	100,809	1,555,789	367,918	1,318,687	100,961	3,444,164	2,709,530
<b>Equipment (net of accumulated depreciation)</b>	<u>28</u>	<u>348</u>	<u>52</u>	<u>578</u>	<u>6</u>	<u>1,012</u>	<u>1,199</u>
<b>Total Assets</b>	<u>421,611</u>	<u>6,488,200</u>	<u>1,537,603</u>	<u>5,498,434</u>	<u>420,204</u>	<u>14,366,052</u>	<u>13,626,015</u>
<b>LIABILITIES</b>							
Accounts payable	289	3,092	909	3,922	128	8,340	8,446
Securities lending collateral	<u>100,809</u>	<u>1,555,789</u>	<u>367,918</u>	<u>1,318,687</u>	<u>100,961</u>	<u>3,444,164</u>	<u>2,709,530</u>
<b>Total Liabilities</b>	<u>101,098</u>	<u>1,558,881</u>	<u>368,827</u>	<u>1,322,609</u>	<u>101,089</u>	<u>3,452,504</u>	<u>2,717,976</u>
<b>Plan Net Assets Held in Trust for Pension Benefits</b>	<u>\$ 320,513</u>	<u>\$ 4,929,319</u>	<u>\$ 1,168,776</u>	<u>\$ 4,175,825</u>	<u>\$ 319,115</u>	<u>\$ 10,913,548</u>	<u>\$ 10,908,039</u>

(A schedule of funding progress for each plan is presented on pages 31-36)

See accompanying independent auditor's report and notes to financial statements

## KENTUCKY RETIREMENT SYSTEMS

### COMBINING STATEMENTS OF CHANGES IN PLAN NET ASSETS--PENSION FUNDS

Years Ended June 30, 2003 and 2002

(Dollars in Thousands)

	KERS <u>Hazardous</u>	KERS <u>Non-Hazardous</u>	CERS <u>Hazardous</u>	CERS <u>Non-Hazardous</u>	State <u>Police</u>	2003 <u>Total</u>	2002 Total <u>(Restated)</u>
<b>ADDITIONS</b>							
Members' contributions	\$ 11,553	\$ 137,124	\$ 36,203	\$ 125,301	\$ 4,674	\$ 314,855	\$ 286,822
Employers' contributions	<u>7,322</u>	<u>7,597</u>	<u>16,906</u>	<u>11,856</u>	<u>(20)</u>	<u>43,661</u>	<u>26,260</u>
<b>Total contributions</b>	18,875	144,721	53,109	137,157	4,654	358,516	313,082
<b>INVESTMENT INCOME</b>							
From investing activities							
Net appreciation (depreciation) in fair value							
of investments	5,566	50,102	12,185	38,004	4,115	109,972	(868,579)
Interest	6,494	104,393	24,204	86,970	6,881	228,942	240,540
Dividends	<u>2,760</u>	<u>44,374</u>	<u>10,289</u>	<u>36,969</u>	<u>2,925</u>	<u>97,317</u>	<u>130,801</u>
<b>Total investing activities income (loss)</b>	14,820	198,869	46,678	161,943	13,921	436,231	(497,238)
<b>Investment expense</b>	217	3,313	790	2,851	214	7,385	7,295
<b>Commissions</b>	<u>91</u>	<u>1,401</u>	<u>331</u>	<u>1,187</u>	<u>91</u>	<u>3,101</u>	<u>3,990</u>
<b>Total investing activities expense</b>	<u>308</u>	<u>4,714</u>	<u>1,121</u>	<u>4,038</u>	<u>305</u>	<u>10,486</u>	<u>11,285</u>
<b>Net income from investing activities</b>	<u>14,512</u>	<u>194,155</u>	<u>45,557</u>	<u>157,905</u>	<u>13,616</u>	<u>425,745</u>	<u>(508,523)</u>
<b>From Securities Lending Activities</b>							
Securities lending income	1,577	13,621	4,504	15,295	928	35,925	60,496
Securities lending expense:							
Security borrower rebates	1,279	11,080	3,655	12,428	749	29,191	47,021
Security lending agent fees	<u>68</u>	<u>590</u>	<u>194</u>	<u>662</u>	<u>40</u>	<u>1,554</u>	<u>2,964</u>
<b>Net income from securities lending activities</b>	<u>230</u>	<u>1,951</u>	<u>655</u>	<u>2,205</u>	<u>139</u>	<u>5,180</u>	<u>10,511</u>
<b>Total net investment income</b>	<u>14,742</u>	<u>196,106</u>	<u>46,212</u>	<u>160,110</u>	<u>13,755</u>	<u>430,925</u>	<u>(498,012)</u>
<b>Total Additions</b>	33,617	340,827	99,321	297,267	18,409	789,441	(184,930)

	<u>KERS Hazardous</u>	<u>KERS Non-Hazardous</u>	<u>CERS Hazardous</u>	<u>CERS Non-Hazardous</u>	<u>State Police</u>	<u>2003 Total</u>	<u>2002 Total (Restated)</u>
<b>DEDUCTIONS</b>							
Benefit payments	\$ 13,373	\$ 404,896	\$ 72,532	\$ 230,317	\$ 27,862	\$ 748,980	\$ 640,859
Refunds	1,160	7,258	1,794	10,213	97	20,522	17,918
Administrative expenses	<u>404</u>	<u>4,959</u>	<u>737</u>	<u>8,244</u>	<u>86</u>	<u>14,430</u>	<u>12,603</u>
<b>Total deductions</b>	<u>14,937</u>	<u>417,113</u>	<u>75,063</u>	<u>248,774</u>	<u>28,045</u>	<u>783,932</u>	<u>671,380</u>
<b>Net increase (decrease) in plan assets</b>	18,680	(76,286)	24,258	48,493	(9,636)	5,509	(856,310)
<b>Plan net assets held in trust for Pension Benefits</b>							
<b>Beginning of Year (as previously reported for 2002)</b>	301,833	5,005,605	1,144,518	4,127,332	328,751	10,908,039	11,763,201
<b>Adjustment for Change in Accounting Method</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,148</u>
<b>Beginning of Year (as restated for 2002)</b>	<u>301,833</u>	<u>5,005,605</u>	<u>1,144,518</u>	<u>4,127,332</u>	<u>328,751</u>	<u>10,908,039</u>	<u>11,764,349</u>
<b>End of Year (as restated for 2002)</b>	<u>\$ 320,513</u>	<u>\$ 4,929,319</u>	<u>\$ 1,168,776</u>	<u>\$ 4,175,825</u>	<u>\$ 319,115</u>	<u>\$ 10,913,548</u>	<u>\$ 10,908,039</u>

See accompanying independent auditor's report and notes to financial statements

## KENTUCKY RETIREMENT SYSTEMS

### COMBINING STATEMENTS OF PLAN NET ASSETS--POST-EMPLOYMENT HEALTHCARE

June 30, 2003 and 2002

(Dollars in Thousands)

ASSETS	KERS	KERS	CERS	CERS	State	2003	2002
	<u>Hazardous</u>	<u>Non-Hazardous</u>	<u>Hazardous</u>	<u>Non-Hazardous</u>	<u>Police</u>	<u>Total</u>	<u>Total</u>
<b>Cash and short-term investments</b>							
Cash	\$ 25	\$ 31	\$ 82	\$ 64	\$ 14	\$ 216	\$ 24,940
Short-term investments	<u>8,203</u>	<u>89,312</u>	<u>15,308</u>	<u>29,905</u>	<u>4,282</u>	<u>147,010</u>	<u>142,008</u>
<b>Total cash and short-term investments</b>	8,228	89,343	15,390	29,969	4,296	147,226	166,948
<b>Receivables</b>							
Investments - accounts receivable	6	21	12	22	2	63	70
Interest receivable - year end	328	1,180	560	1,104	199	3,371	3,027
Accounts receivable - year end	<u>1,334</u>	<u>5,457</u>	<u>3,653</u>	<u>10,695</u>	<u>651</u>	<u>21,790</u>	<u>26,494</u>
<b>Total receivables</b>	1,668	6,658	4,225	11,821	852	25,224	29,591
<b>Investments, at fair value</b>							
Corporate and government bonds	12,871	48,016	21,287	42,820	8,247	133,241	119,766
Corporate stocks	<u>102,823</u>	<u>343,727</u>	<u>182,396</u>	<u>351,228</u>	<u>59,192</u>	<u>1,039,366</u>	<u>881,263</u>
<b>Total investments</b>	115,694	391,743	203,683	394,048	67,439	1,172,607	1,001,029
<b>Security lending collateral invested</b>	<u>31,894</u>	<u>134,627</u>	<u>53,881</u>	<u>104,216</u>	<u>19,798</u>	<u>344,416</u>	<u>204,493</u>
<b>Total Assets</b>	<u>157,484</u>	<u>622,371</u>	<u>277,179</u>	<u>540,054</u>	<u>92,385</u>	<u>1,689,473</u>	<u>1,402,061</u>
<b>LIABILITIES</b>							
Accounts payable	68	673	130	338	49	1,258	1,193
Securities lending collateral obligations	<u>31,894</u>	<u>134,627</u>	<u>53,881</u>	<u>104,216</u>	<u>19,798</u>	<u>344,416</u>	<u>204,493</u>
<b>Total Liabilities</b>	<u>31,962</u>	<u>135,300</u>	<u>54,011</u>	<u>104,554</u>	<u>19,847</u>	<u>345,674</u>	<u>205,686</u>
<b>Plan Net Assets Held in Trust for Post-Employment Healthcare Benefits</b>	<u>\$ 125,522</u>	<u>\$ 487,071</u>	<u>\$ 223,168</u>	<u>\$ 435,500</u>	<u>\$ 72,538</u>	<u>\$ 1,343,799</u>	<u>\$ 1,196,375</u>

(A schedule of funding progress for each plan is presented on pages 31-36)

See accompanying independent auditor's report and notes to financial statements

## KENTUCKY RETIREMENT SYSTEMS

### COMBINING STATEMENTS OF CHANGES IN PLAN NET ASSETS--POST-EMPLOYMENT HEALTHCARE

Years Ended June 30, 2003 and 2002

(Dollars in Thousands)

	<u>KERS Hazardous</u>	<u>KERS Non-Hazardous</u>	<u>CERS Hazardous</u>	<u>CERS Non-Hazardous</u>	<u>State Police</u>	<u>2003 Total</u>	<u>2002 Total</u>
<b>ADDITIONS</b>							
Employers' contributions	\$ 15,883	\$ 65,335	\$ 45,244	\$ 99,235	\$ 7,654	\$ 233,351	\$ 267,260
<b>Total contributions</b>	15,883	65,335	45,244	99,235	7,654	233,351	267,260
<b>INVESTMENT INCOME</b>							
From investing activities							
Net appreciation (depreciation) in fair value of investments	719	146	1,735	3,576	96	6,272	(134,227)
Demutualization proceeds	-	-	-	-	-	-	61,603
Interest	684	2,582	1,175	2,287	413	7,141	13,147
Dividends	1,453	5,482	2,496	4,857	876	15,164	7,149
<b>Total income (loss) from investing activities</b>	2,856	8,210	5,406	10,720	1,385	28,577	(52,328)
<b>Investment activities expense</b>	52	183	84	170	33	522	451
<b>Commissions</b>	35	138	63	121	21	378	430
<b>Total investing activities expense</b>	87	321	147	291	54	900	881
<b>Net investing activities income (loss)</b>	2,769	7,889	5,259	10,429	1,331	27,677	(53,209)
<b>From Securities Lending Activities</b>							
Securities lending income	364	872	546	1,036	162	2,980	4,242
Securities lending expense:							
Security borrower rebates	281	670	418	792	125	2,286	3,325
Security lending agent fees	17	41	26	48	8	140	186
<b>Net income from securities lending activities</b>	66	161	102	196	29	554	731
<b>Total net investment income (loss)</b>	2,835	8,050	5,361	10,625	1,360	28,231	(52,478)
<b>Total Additions</b>	18,718	73,385	50,605	109,860	9,014	261,582	214,782



	<u>KERS</u> <u>Hazardous</u>	<u>KERS</u> <u>Non-Hazardous</u>	<u>CERS</u> <u>Hazardous</u>	<u>CERS</u> <u>Non-Hazardous</u>	<u>State</u> <u>Police</u>	<u>2003</u> <u>Total</u>	<u>2002</u> <u>Total</u>
<b>DEDUCTIONS</b>							
Healthcare premiums subsidies	\$ 2,938	\$ 51,586	\$ 14,866	\$ 39,387	\$ 4,519	\$ 113,296	\$ 96,104
Administrative fees	<u>27</u>	<u>393</u>	<u>105</u>	<u>306</u>	<u>31</u>	<u>862</u>	<u>778</u>
<b>Total deductions</b>	<u>2,965</u>	<u>51,979</u>	<u>14,971</u>	<u>39,693</u>	<u>4,550</u>	<u>114,158</u>	<u>96,882</u>
<b>Net increase in plan assets</b>	15,753	21,406	35,634	70,167	4,464	147,424	117,900
<b>Plan net assets held in trust for post-employment healthcare benefit</b>							
<b>Beginning of Year</b>	<u>109,769</u>	<u>465,665</u>	<u>187,534</u>	<u>365,333</u>	<u>68,074</u>	<u>1,196,375</u>	<u>1,078,475</u>
<b>End of Year</b>	<u>\$ 125,522</u>	<u>\$ 487,071</u>	<u>\$ 223,168</u>	<u>\$ 435,500</u>	<u>\$ 72,538</u>	<u>\$ 1,343,799</u>	<u>\$ 1,196,375</u>

See accompanying independent auditor's report and notes to financial statements

## KENTUCKY RETIREMENT SYSTEMS

### NOTES TO FINANCIAL STATEMENTS

June 30, 2003 and 2002

Under the provisions of Kentucky Revised Statute Section 61.645, the Board of Trustees of Kentucky Retirement Systems (KRS) administers the Kentucky Employees Retirement System (KERS), County Employees Retirement System (CERS), and State Police Retirement System (SPRS). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to the members of that plan, in accordance with the provisions of Kentucky Revised Statute Sections 16.555, 61.570, and 78.630.

Under the provisions of Kentucky Revised Statute Section 61.701, the Board of Trustees of Kentucky Retirement Systems (KRS) administers the Kentucky Retirement Systems Insurance Fund. The statutes provide for a single insurance fund to provide group hospital and medical benefits to retirees drawing a benefit from the three pension funds administered by Kentucky Retirement Systems: (1) Kentucky Employees Retirement System (KERS); (2) County Employees Retirement System (CERS); and (3) State Police Retirement System (SPRS). KRS maintains separate accounting records for five insurance funds which also includes hazardous duty members of the Kentucky Employees and County Employees Retirement Systems. The assets of the various insurance funds are commingled for investment purposes. The following notes apply to the various funds administered by Kentucky Retirement Systems.

#### NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - KRS's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with terms of the plan. Premium payments are recognized when due and payable in accordance with terms of the plan.

Method Used to Value Investments - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate is based on appraisals. Investments that do not have an established market are reported at estimated fair value.

Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Equipment - Equipment is valued at historical cost and depreciation is computed utilizing the straight-line method over the estimated useful lives of the assets ranging from three to ten years.

Expense Allocation - Administrative and investment expenses of the Kentucky Retirement Systems are allocated in proportion to the number of active members participating in each plan and the carrying value of plan investments, respectively.

Reclassification - Certain amounts in 2002 have been reclassified to conform with the 2003 presentation. Such reclassifications had no effect on reported increase or decrease in plan net assets.

Continued

## KENTUCKY RETIREMENT SYSTEMS

### NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

#### NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--CONTINUED

Component Unit - Kentucky Retirement Systems is a component unit of the Commonwealth of Kentucky. As such, the Commonwealth of Kentucky is the primary government in whose financial reporting entity the System is included.

The Kentucky Employees Retirement System was created by the Kentucky General Assembly pursuant to the provisions of KRS 61.515. The County Employees Retirement System was created by the Kentucky General Assembly pursuant to the provisions of KRS 78.520. The State Police Retirement System was created by the Kentucky General Assembly pursuant to the provisions of KRS 16.510. The Kentucky Retirement Systems Insurance Fund consisting of the Kentucky employees Insurance Fund, Kentucky Employee Hazardous Insurance Fund, County Employees Insurance Fund, County Employees Hazardous Insurance Fund and State Police Insurance Fund was created by the Kentucky General Assembly pursuant to the provisions of KRS 61.701. The Retirement Systems' and Insurance Fund's administrative budget is subject to approval by the Kentucky General Assembly. Employer contribution rates for KERS and SPRS are also subject to legislative approval. Employer contribution rates for CERS are determined by the Systems' Board of Trustees without further legislative review. The methods used to determine the employer rates for all Retirement Systems are specified in KRS 61.565. Employee contribution rates are set by statute and may be changed only by the Kentucky General Assembly.

#### NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

Membership of each Retirement plan consisted of the following at June 30, 2003 and 2002:

##### KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	2003			2002		
	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
Retirees and beneficiaries receiving benefits	27,182	1,365	28,547	26,703	1,208	27,911
Inactive Vested Retirements	3,892	169	4,061	3,415	127	3,542
Inactive Vested Memberships	17,320	1,233	18,553	14,299	946	15,245
Active plan members	<u>49,586</u>	<u>4,203</u>	<u>53,789</u>	<u>48,555</u>	<u>4,211</u>	<u>52,766</u>
Total	<u>97,980</u>	<u>6,970</u>	<u>104,950</u>	<u>92,972</u>	<u>6,492</u>	<u>99,464</u>
Number of participating employers			410			404

Continued

**KENTUCKY RETIREMENT SYSTEMS**

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

**NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED**

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

<u>Number of Members</u>	<u>2003</u>			<u>2002</u>		
	<u>Non-Hazardous Position Employees</u>	<u>Hazardous Position Employees</u>	<u>Total</u>	<u>Non-Hazardous Position Employees</u>	<u>Hazardous Position Employees</u>	<u>Total</u>
Retirees and beneficiaries receiving benefits	27,057	3,787	30,844	26,147	3,483	29,630
Inactive Vested Retirements	5,147	193	5,340	4,470	148	4,618
Inactive Vested Memberships	30,573	873	31,446	26,508	552	27,060
Active plan members	<u>83,142</u>	<u>9,587</u>	<u>92,729</u>	<u>79,850</u>	<u>8,949</u>	<u>88,799</u>
Total	<u>145,919</u>	<u>14,440</u>	<u>160,359</u>	<u>136,975</u>	<u>13,132</u>	<u>150,107</u>
Number of participating employers			1,367			1,314

**STATE POLICE RETIREMENT SYSTEM**

<u>Number of Members</u>	<u>2003</u>	<u>2002</u>
	<u>Hazardous Position Employees</u>	<u>Hazardous Position Employees</u>
Retirees and beneficiaries receiving benefits	966	897
Inactive Vested Retirements	43	20
Inactive Vested Memberships	186	83
Active plan members	<u>1,022</u>	<u>1,002</u>
Total	2,217	2,002
Number of participating employers	1	1

Continued

## KENTUCKY RETIREMENT SYSTEMS

### NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

### NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED

#### KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND

Hospital and medical contracts in force consisted of the following at June 30, 2003 and 2002:

	2003					2002				
	Single	Couple/ Family	Parent + Regular	Medicare Regular	Medicare High	Single	Couple/ Family	Parent + Regular	Medicare Regular	Medicare High
KERS Non-Hazardous	6,602	1,298	428	1,855	11,311	5,822	1,182	396	1,838	11,229
KERS Hazardous	417	234	53	62	494	359	205	57	66	451
CERS Non-Hazardous	5,054	855	244	2,630	9,958	4,530	800	224	2,446	9,517
CERS Hazardous	1,010	1,379	223	40	808	956	1,321	210	38	734
SPRS	<u>218</u>	<u>384</u>	<u>44</u>	<u>13</u>	<u>312</u>	<u>199</u>	<u>364</u>	<u>50</u>	<u>11</u>	<u>303</u>
Totals	13,301	4,150	992	4,600	22,883	11,866	3,872	937	4,399	22,234

#### KENTUCKY EMPLOYEES RETIREMENT SYSTEM

##### Non-Hazardous Employees Pension Plan

Plan Description - KERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of any state department, board, or agency directed by Executive Order to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent in any plan year. The General Assembly reserves the right to suspend or reduce cost-of-living adjustments if in its judgment the welfare of the Commonwealth so demands.

Contributions - For the years ended June 30, 2003 and 2002, plan members were required to contribute 5% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the year ended June 30, 2003, the contribution rate for some employers participating in KERS was 3.76% of creditable compensation and 5.89% of creditable compensation for some KERS employers pursuant to legislation enacted by the 2003 General Assembly [HB269, FCCR1, Part III, General Provisions, Paragraph 18 (2003)]. For the year ended June 30, 2002, the rate was 5.89%. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 5.89% of creditable compensation. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

Continued

## **KENTUCKY RETIREMENT SYSTEMS**

### **NOTES TO FINANCIAL STATEMENTS--CONTINUED**

June 30, 2003 and 2002

#### **NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED**

##### **Hazardous Employees Pension Plan**

Plan Description - KERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in hazardous duty positions of any state department, board, or agency directed by Executive Order to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent in any plan year. The General Assembly reserves the right to suspend or reduce cost-of-living adjustments if in its judgment the welfare of the Commonwealth so demands.

Contributions - For the years ended June 30, 2003 and 2002, plan members were required to contribute 8% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the year ended June 30, 2003, the contribution rate for some employers participating in KERS was 17.60% and for some employers in KERS was 18.84% of creditable compensation pursuant to legislation enacted by the 2003 General Assembly [HB269, FCCR1, Part III, General Provisions, Paragraph 18 (2003)]. For the year ended June 30, 2002, the rate was 18.84%. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 18.84% of creditable compensation. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

#### **COUNTY EMPLOYEES RETIREMENT SYSTEM**

##### **Non-Hazardous Employees Pension Plan**

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

Continued

## KENTUCKY RETIREMENT SYSTEMS

### NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

#### NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED

Contributions - For the years ended June 30, 2003 and 2002, plan members were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the years ended June 30, 2003 and 2002, participating employers contributed 6.34% and 6.41%, respectively, of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 6.34% and 6.41%, respectively. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

#### Hazardous Employees Pension Plan

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

Contributions - For the years ended June 30, 2003 and 2002, plan members were required to contribute 8% of their annual creditable compensation. The participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the years ended June 30, 2003 and 2002, participating employers contributed 16.28% of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 16.28% of creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

#### STATE POLICE RETIREMENT SYSTEM

Plan Description - SPRS is a single-employer defined benefit pension plan that covers all full-time State Troopers employed in a hazardous duty position by the Kentucky State Police. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

Continued

## KENTUCKY RETIREMENT SYSTEMS

### NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

#### NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED

Contributions - For the years ended June 30, 2003 and 2002 plan members were required to contribute 8% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the years ended June 30, 2003 and 2002, the State contributed 17.37% and 21.58%, respectively, of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 21.58% of creditable compensation. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

#### KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND

Plan Description - The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System (Systems). The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. For the year insurance premiums withheld from benefit payments to members of the Systems approximated \$22,384,767 and \$659,533 for KERS and KERS hazardous, respectively, \$20,456,708 and \$2,242,457 for CERS and CERS hazardous, respectively, and \$581,251 for SPRS. The Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous members killed in the line of duty. As of June 30, 2003 the Fund had 60,357 retirees and beneficiaries for whom benefits were available.

The amount of contribution paid by the Fund is based on years of service with the Systems. Years of service and respective percentages of the maximum contribution are as follows:

<u>Years of Service</u>	<u>Percent Paid by Insurance Fund</u>
20 or More	100%
15 - 19	75%
10 - 14	50%
4 - 9	25%
Less Than 4	0%

In prior years, the employers' required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20-year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed.

In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years. The increases commenced with the 1997 valuation and adjustments will be made every other valuation year to coincide with the valuation used by the General Assembly to establish employer contribution rates for the biennium.



## KENTUCKY RETIREMENT SYSTEMS

### NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

#### NOTE C--CASH AND SHORT-TERM INVESTMENTS AND SECURITIES LENDING COLLATERAL

The provisions of Governmental Accounting Standards Board Statement No. 28, "Accounting and Financial Reporting for Securities Lending Transactions" require that cash received as collateral on securities lending transactions and investments made with that cash be reported as assets on the financial statements. In conjunction with the adoption of Governmental Accounting Standard No. 28, the System has reclassified certain other investments, not related to the securities lending program, as short-term. Cash and short-term investments consist of the following:

##### KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	<u>2003</u>	<u>2002</u>
Miscellaneous cash	\$ 525,299	\$ 12,580,710
Short-Term Investment Pool	1,656,597,564	1,318,840,638
Repurchase agreements	<u>170,917,610</u>	<u>260,745,038</u>
Total	<u>\$1,828,040,473</u>	<u>\$ 1,592,166,386</u>

##### COUNTY EMPLOYEES RETIREMENT SYSTEM

	<u>2003</u>	<u>2002</u>
Miscellaneous Cash	\$ 832,473	\$ 14,647,210
Short-Term Investment Pool	1,686,604,839	1,308,851,954
Repurchase agreements	<u>306,549,501</u>	<u>269,469,918</u>
Total	<u>\$1,993,986,813</u>	<u>\$ 1,592,969,082</u>

##### STATE POLICE RETIREMENT SYSTEM

	<u>2003</u>	<u>2002</u>
Miscellaneous Cash	134,759	1,266,091
Short-Term Investment Pool	100,961,178	81,837,844
Repurchase agreements	<u>8,285,357</u>	<u>17,843,020</u>
Total	<u>\$ 109,381,294</u>	<u>\$ 100,946,955</u>

##### KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND

	<u>2003</u>	<u>2002</u>
Miscellaneous Cash	215,516	24,939,638
Short-Term Investment Pool	344,416,324	204,492,843
Repurchase agreements	<u>147,009,999</u>	<u>142,008,460</u>
Total	<u>\$ 491,641,839</u>	<u>\$ 371,440,941</u>

## KENTUCKY RETIREMENT SYSTEMS

### NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

#### NOTE D--INVESTMENTS

The Board of Trustees of the Retirement Systems and Insurance Fund recognize their duty to invest funds in accordance with the Prudent Person Rule and manage those funds consistent with the long-term nature of the Systems. The Board enters into contracts with investment managers who use the following guidelines and restrictions in the selection and timing of transactions as long as the security is not prohibited by the Kentucky Revised Statutes.

Equity Investments - Investments may be made in domestic and international common stock, securities convertible into common stock and in preferred stock of publicly traded corporations.

Fixed Income Investments - Publicly traded corporate bonds are to be selected and managed to assure an appropriate balance in quality and maturities consistent with the current market and economic conditions. Investment may also be made in any debt instrument issued or guaranteed in whole or in part by the U.S. Government or any agency or instrumentality of the U.S. Government.

Mortgages - Investment may be made in real estate mortgages on a direct basis or in the form of mortgage pool instruments guaranteed by an agency of the U.S. Government or the Commonwealth of Kentucky.

Alternative Investments/Equity Real Estate – Subject to the specific approval of the investment committee of the board of trustees, investments may be made for the purpose of creating a diversified portfolio of alternative investments. The board may invest in real estate or alternative investments including, without limitation, venture capital, private equity and private placements which the investment committee believes has excellent potential to generate income and which may have a higher degree of risk.

Cash Equivalent Securities - The following short-term investment vehicles are considered acceptable:

Publicly traded investment grade corporate bonds, government and agency bonds, mortgages, and collective STIF's, money market funds or instruments (including, but not limited to, certificates of deposit, bank notes, deposit notes, bankers' acceptances and commercial paper) and repurchase agreements relating to the above instruments. Instruments may be selected from among those having a BBB or better rating by at least one recognized bond rating service. All instruments shall have a maturity at the time of purchase that does not exceed two years. Repurchase agreements shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur.

Derivatives – Investments may be made in derivative securities, or strategies which make use of derivative instruments, only if such investments do not cause the portfolio to be in any way leveraged beyond a 100% invested position. Investments in derivative securities which are subject to large or unanticipated changes in duration or cash flow, such as interest only (IO), principal only (PO), inverse floater, or structured note securities are expressly prohibited.

The Retirement Systems and Insurance Fund invest in collateral mortgage obligations (CMOs) and other asset-backed securities to increase return and adjust duration of the portfolio. The Systems and the Fund invest in exchange-traded funds to convert cash held in index funds to short-term equity investments. This practice is intended to make the performance of the index funds more closely track the performance of the index that the funds are intended to replicate.

Continued

## **KENTUCKY RETIREMENT SYSTEMS**

### **NOTES TO FINANCIAL STATEMENTS--CONTINUED**

June 30, 2003 and 2002

#### **NOTE D--INVESTMENTS--CONTINUED**

Collateral mortgage obligations, asset-backed securities, and exchange-traded funds pose no greater risk than other similar investment grade holdings in the Systems' and the Fund's portfolios. The fair value of CMOs at June 30, 2003 and 2002 was approximately \$80 million and \$137 million respectively; the fair value of asset-backed securities at June 30, 2003 and 2002 was approximately \$310 million and \$141 million respectively; and the fair value of exchange-traded funds at June 30, 2003 and 2002 was approximately \$188 million and \$191 million, respectively.

The Retirement Systems' and Insurance Fund's investments are categorized on pages 23 through 26 to give an indication of the level of risk assumed by them at June 30, 2003 and 2002. Category 1 includes investments that are either insured or registered or for which the investments are held by the System or its agent in the System's name. Category 3 includes securities purchased by and held by the System's custodial agent. The agent loans securities owned by the Systems and Fund with the simultaneous receipt of cash collateral. The custodial agent purchases securities with the cash collateral in accordance with the Systems' and Fund's Statement of Investment Policy. All securities purchased with cash collateral are segregated by the custodial agent and held in the name of Kentucky Retirement Systems. At June 30, 2003, the systems had a second agent who also loans securities owned by the systems with the simultaneous receipt of cash collateral. The second custodial agent invests cash collateral in a short-term investment pool that holds only U.S. dollar cash and U.S. securities.

Continued

**KENTUCKY RETIREMENT SYSTEMS**

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

**NOTE D--INVESTMENTS--CONTINUED**

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

Investments - Categorized	2003			Fair Value
	Category 1	Category 2	Category 3	
U.S. Government Securities	\$ 669,755,421	\$ -	\$ 3,809,832	\$ 673,565,253
Loaned for securities collateral	48,609,045	-	-	48,609,045
Corporate bonds	588,972,872	-	-	588,972,872
Corporate stocks	2,299,125,931	-	130	2,299,126,062
Loaned for securities collateral	1,719,201	-	-	1,719,201
Repurchase agreements	<u>167,987,935</u>	<u>-</u>	<u>2,929,676</u>	<u>170,917,610</u>
Subtotal	3,776,170,405	-	6,739,638	3,782,910,043
<b>Investments - Not Categorized</b>				
Short-term Investment Pool	-	-	-	1,656,597,564
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	504,017,197
Corporate bonds	-	-	-	61,722,729
Corporate stocks	-	-	-	561,512,794
Mortgages	-	-	-	273,115,545
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,635,101</u>
Total Investments	<u>\$3,776,170,405</u>	<u>\$ -</u>	<u>\$ 6,739,638</u>	<u>\$6,848,510,973</u>
	2002			
Investments - Categorized	Category 1	Category 2	Category 3	Fair Value
U.S. Government Securities	\$ 113,768,072	\$ -	\$ 6,257,731	\$ 120,025,803
Loaned for securities collateral	250,546,768	-	-	250,546,768
Corporate bonds	545,042,869	-	-	545,042,869
Loaned for securities collateral	5,102,948	-	-	5,102,948
Corporate stocks	2,452,194,242	-	129	2,452,194,371
Loaned for securities collateral	444,848	-	-	444,848
Repurchase agreements	<u>259,255,343</u>	<u>-</u>	<u>1,495,823</u>	<u>260,751,166</u>
Subtotal	3,626,355,090	-	7,753,683	3,634,108,773
<b>Investments - Not Categorized</b>				
Short-term Investment Pool	-	-	-	1,318,840,638
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	806,544,819
Corporate bonds	-	-	-	67,680,028
Corporate stocks	-	-	-	403,320,388
Mortgages	-	-	-	313,339,066
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>11,103,333</u>
Total Investments	<u>\$3,626,335,090</u>	<u>\$ -</u>	<u>\$ 7,753,683</u>	<u>\$6,554,937,045</u>

Continued

**KENTUCKY RETIREMENT SYSTEMS**

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

**NOTE D--INVESTMENTS--CONTINUED**

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

Investments - Categorized	2003			Fair Value
	Category 1	Category 2	Category 3	
U.S. Government Securities	\$ 209,130,474	\$ -	\$ 3,879,310	\$ 213,009,784
Loaned for securities collateral	483,521,727	-	-	483,521,727
Corporate bonds	574,044,312	-	-	574,044,312
Loaned for securities collateral	5,047,609	-	-	5,047,609
Corporate stocks	2,265,011,128	-	133	2,265,011,261
Loaned for securities collateral	13,724,905	-	-	13,724,905
Repurchase agreements	<u>303,566,399</u>	-	<u>2,983,102</u>	<u>306,549,501</u>
Subtotal	3,854,046,554	-	6,862,545	3,860,909,099
<b>Investments - Not Categorized</b>				
Short-Term Investment Pool	-	-	-	1,686,604,839
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	513,146,864
Corporate bonds	-	-	-	62,840,762
Corporate stocks	-	-	-	571,683,924
Mortgages	-	-	-	269,920,205
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,796,669</u>
Total Investments	<u>\$3,854,046,554</u>	<u>\$ -</u>	<u>\$ 6,862,545</u>	<u>\$6,972,902,362</u>
	2002			
Investments - Categorized	Category 1	Category 2	Category 3	Fair Value
U.S. Government Securities	\$ 106,558,508	\$ -	\$ 6,176,452	\$ 112,734,960
Loaned for securities collateral	248,649,168	-	-	248,649,168
Corporate bonds	537,565,238	-	-	537,565,238
Loaned for securities collateral	5,064,299	-	-	5,064,299
Corporate stocks	2,433,226,793	-	124	2,433,226,917
Loaned for securities collateral	441,479	-	-	441,479
Repurchase agreements	<u>267,991,504</u>	-	<u>1,478,414</u>	<u>269,469,918</u>
Subtotal	3,599,496,989	-	7,654,990	3,607,151,979
<b>Investments - Not Categorized</b>				
Short-Term Investment Pool	-	-	-	1,308,851,954
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	800,442,229
Corporate bonds	-	-	-	67,167,431
Corporate stocks	-	-	-	400,265,705
Mortgages	-	-	-	309,695,477
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,580,920</u>
Total Investments	<u>\$3,599,496,989</u>	<u>\$ -</u>	<u>\$ 7,654,990</u>	<u>\$6,503,155,695</u>

Continued

**KENTUCKY RETIREMENT SYSTEMS**

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

**NOTE D--INVESTMENTS--CONTINUED**

**STATE POLICE RETIREMENT SYSTEM**

<b>Investments - Categorized</b>	2003			<b>Fair Value</b>
	<b>Category 1</b>	<b>Category 2</b>	<b>Category 3</b>	
U.S. Government Securities	\$ 16,405,761	\$ -	\$ 232,170	\$ 16,637,931
Loaned for securities collateral	28,943,901	-	-	28,943,901
Corporate bonds	36,425,347	-	-	36,425,347
Loaned for securities collateral	302,153	-	-	302,153
Corporate stocks	138,380,614	-	8	138,380,622
Loaned for securities collateral	821,581	-	-	821,581
Repurchase agreements	<u>8,106,824</u>	<u>-</u>	<u>178,533</u>	<u>8,285,357</u>
Subtotal	229,386,181	-	410,711	229,796,892
<b>Investments - Not Categorized</b>				
Short-Term Investment Pool	-	-	-	100,961,178
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	30,717,279
Corporate bonds	-	-	-	3,761,686
Corporate stocks	-	-	-	34,221,343
Mortgages	-	-	-	16,969,831
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>823,918</u>
Total Investments	<u>\$ 229,386,181</u>	<u>\$ -</u>	<u>\$ 410,711</u>	<u>\$ 417,252,127</u>
2002				
<b>Investments - Categorized</b>	<b>Category 1</b>	<b>Category 2</b>	<b>Category 3</b>	<b>Fair Value</b>
U.S. Government Securities	\$ 8,834,473	\$ -	\$ 397,807	\$ 9,232,280
Loaned for securities collateral	15,547,146	-	-	15,547,146
Corporate bonds	34,758,002	-	-	34,758,002
Loaned for securities collateral	316,653	-	-	316,653
Corporate stocks	146,882,275	-	-	146,882,275
Loaned for securities collateral	27,604	-	-	27,604
Repurchase agreements	<u>17,750,580</u>	<u>-</u>	<u>92,440</u>	<u>17,843,020</u>
Subtotal	224,116,733	-	490,247	224,606,980
<b>Investments - Not Categorized</b>				
Short-Term Investment Pool	-	-	-	81,837,844
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	50,048,419
Corporate bonds	-	-	-	4,199,740
Corporate stocks	-	-	-	25,027,187
Mortgages	-	-	-	19,484,961
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,014,934</u>
Total Investments	<u>\$ 224,116,733</u>	<u>\$ -</u>	<u>\$ 490,247</u>	<u>\$ 406,220,066</u>

Continued

**KENTUCKY RETIREMENT SYSTEMS**

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

**NOTE D--INVESTMENTS--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

<b>Investments - Categorized</b>	2003			<b>Fair Value</b>
	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	
U.S. Government Securities	\$ -	\$ -	\$ -	\$ -
Loaned for securities collateral	104,484,853	-	-	104,484,853
Corporate stocks	827,298,990	-	-	827,298,990
Loaned for securities collateral	16,750,685	-	-	16,750,685
Repurchase agreements	<u>145,186,891</u>	<u>-</u>	<u>1,823,108</u>	<u>147,009,999</u>
Subtotal	1,093,721,419	-	1,823,108	1,095,544,527
<b>Investments - Not Categorized</b>				
Short-term investment pool	-	-	-	344,416,324
Investments held by broker-dealers under securities loans:	-	-	-	28,755,858
U.S. Government Securities	-	-	-	195,316,898
Corporate stocks	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Mortgage	-	-	-	-
Total Investments	<u>\$1,093,721,419</u>	<u>\$ -</u>	<u>\$ 1,823,108</u>	<u>\$1,664,033,607</u>

<b>Investments - Categorized</b>	2002			<b>Fair Value</b>
	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	
U.S. Government Securities	\$ 14,644,105	\$ -	\$ -	\$ 14,644,105
Loaned for securities collateral	12,342,559	-	-	12,342,559
Corporate stocks	758,949,817	-	-	758,949,817
Loaned for securities collateral	2,647,879	-	-	2,647,879
Repurchase agreements	<u>141,428,878</u>	<u>-</u>	<u>579,581</u>	<u>142,008,459</u>
Subtotal	930,013,238	-	579,581	930,592,819
<b>Investments - Not Categorized</b>				
Investments held by broker-dealers under securities loans:	-	-	-	204,492,842
U.S. Government Securities	-	-	-	92,779,528
Corporate stocks	<u>-</u>	<u>-</u>	<u>-</u>	<u>119,665,028</u>
Mortgages	-	-	-	-
Total Investments	<u>\$ 930,013,238</u>	<u>\$ -</u>	<u>\$ 579,581</u>	<u>\$1,347,530,217</u>

## **KENTUCKY RETIREMENT SYSTEMS**

### **NOTES TO FINANCIAL STATEMENTS--CONTINUED**

June 30, 2003 and 2002

#### **NOTE E--SECURITIES LENDING TRANSACTIONS**

Kentucky Revised Statutes Sections 61.650 and 386.020(2) permit the Pension and Insurance Funds to lend their securities to broker-dealers and other entities. The borrowers of the securities agree to transfer to the Funds' custodial banks either cash collateral or other securities with a fair value of 102 percent of the value of the borrowed securities. The borrowers of the securities simultaneously agree to return the borrowed securities in exchange for the collateral at a later date. Securities lent for cash collateral are presented as unclassified above in the schedule of custodial credit risk; securities lent for securities collateral are classified according to the category for the securities loaned. At year-end, the Funds have no credit risk exposure to borrowers because the amounts the Funds owe to borrowers exceed the amounts the borrowers owe the Funds. The contracts with the custodial banks require them to indemnify the Funds if the borrowers fail to return the securities and one or both of the custodial banks have failed to live up to their contractual responsibilities relating to the lending of securities.

All securities loans can be terminated on demand by either party to the transaction, although the average term of the loans was 6 days, 10 days, and 24 days for the three investment portfolios subject to security lending agreements. One custodial bank invests cash collateral in securities that are permitted for investment by state statute and board policy, which at year-end has a weighted-average maturity of 3 days for the Funds. The other custodial bank invests cash collateral in the agent's short-term investment pool as permitted by state statute and Board policy, which at year-end has a weighted-average maturity of 24 days for the Pension Fund only. Neither of the Funds can pledge or sell collateral securities received unless the borrower defaults.

#### **NOTE F--RISKS OF LOSS**

KRS is exposed to various risks of loss related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Under the provisions of the Kentucky Revised Statutes, the Kentucky Board of Claims is vested with full power and authority to investigate, hear proof, and to compensate persons for damages sustained to either person or property as a result of negligence of the agency or any of its employees. Awards are limited to \$200,000 for a single claim and \$350,000 in aggregate per occurrence. Awards and a pro rata share of the operating cost of the Board of Claims are paid from the fund of the agency having a claim or claims before the Board.

Claims against the Board of Trustees of Kentucky Retirement Systems or any of its staff as result of actual or alleged breach of fiduciary duty are insured with a commercial insurance policy. Coverage provided is limited to \$5,000,000 with a deductible amount of \$25,000. Defense costs incurred in defending such claims will be paid by the insurance company. However, the total defense cost and claims paid shall not exceed the total aggregate coverage of the policy.

Claims for job-related illnesses or injuries to employees are insured by the state's self-insured workers' compensation program. Payments approved by the program are not subject to maximum limitations. A claimant may receive reimbursement for all medical expenses related to the illness or injury and up to sixty-six and two-thirds percent (66 2/3%) of wages for temporary disability. Each agency pays premiums based on fund reserves and payroll.

Continued



## **KENTUCKY RETIREMENT SYSTEMS**

### **NOTES TO FINANCIAL STATEMENTS--CONTINUED**

June 30, 2003 and 2002

#### **NOTE F--RISKS OF LOSS--CONTINUED**

Only claims pertaining to workers' compensation have been filed during the past three fiscal years. Settlements did not exceed insurance coverage in any of the past three fiscal years. There were no claims which were appealed to the Kentucky Workers' Compensation Board.

#### **NOTE G--CONTINGENCIES**

In the normal course of business, KRS is involved in various litigation concerning the right of participants or their beneficiaries to receive benefits. KRS does not anticipate any material losses as a result of the contingent liabilities.

#### **NOTE H--INCOME TAX STATUS**

The Internal Revenue Service has ruled that KRS qualifies under Section 401(a) of the Internal Revenue Code and is, therefore, not subject to tax under income tax law.

#### **NOTE I--PRIOR PERIOD ADJUSTMENT**

The plan assets of KRS have been restated as of July 1, 2001 to reflect a change in accounting method in the recording of equipment acquisitions. Effective July 1, 2001, KRS changed to recording such equipment acquisitions as capital assets and providing for depreciation of such assets over their respective estimated useful lives utilizing the straight-line method of depreciation. KRS had previously recorded equipment acquisitions as an expense in the period acquired. The net affect of this change in accounting method was an increase of \$1,148,000 to plan net assets as of July 1, 2001.

#### **NOTE J--ANTHEM DEMUTUALIZATION**

In 2002, Anthem Insurance Companies, Inc., an Indiana corporation, underwent a demutualization, as authorized by the Indiana statutes. The demutualization provided, among other things, that "eligible statutory members", as defined by Indiana statutory provision, would receive cash or stock in consideration for giving up their membership interest in Anthem. In some instances application of the statute led to the determination by Anthem that individual members of the retirement plans administered by Kentucky Retirement Systems were the "statutory members" and in other instances the Kentucky Retirement Systems was identified by Anthem as the eligible statutory member to receive cash or stock under the Anthem demutualization plan. According to Anthem, this determination was based upon which of Anthem's subsidiaries was the original provider. The determination was confirmed by the Indiana Department of Insurance.

Continued

## **KENTUCKY RETIREMENT SYSTEMS**

### **NOTES TO FINANCIAL STATEMENTS--CONTINUED**

June 30, 2003 and 2002

#### **NOTE J--ANTHEM DEMUTUALIZATION--CONTINUED**

The \$61,603,207 distribution which Kentucky Retirement Systems received on January 4, 2002 under the Anthem demutualization was deposited in the Kentucky Employees Retirement Systems Insurance Fund. The retirement systems included within the Kentucky Retirement Systems for purposes of the Anthem demutualization are the Kentucky Employees Retirement System, (hazardous and non-hazardous), the County Employees Retirement System (hazardous and non-hazardous), the State Police Retirement System, the Legislators' Retirement Plan, and the Judicial Retirement Plan. Anthem has not yet provided the Kentucky Retirement System with the information necessary to divide the distribution among these retirement funds. Accordingly, the distribution will remain in the Kentucky Employees Retirement Systems Insurance Fund until the interests of the various retirement funds are determined. Given the unusual and non-recurring nature of the transaction, it is reported in these financial statements as a separate component of income.

#### **NOTE K--CONTINGENT LIABILITY--ANTHEM DEMUTUALIZATION**

In relation to the above noted Anthem demutualization, Kentucky Retirement System is a defendant in a case entitled Jean C. Love, David E. Wiseman and Belvia Campbell v. Board of Trustees of the Kentucky Retirement Systems, which is in Franklin Circuit Court. At issue is how to distribute the proceeds resulting from Anthem's demutualization, which resulted in Kentucky Retirement System receiving approximately \$61 million dollars in proceeds. The plaintiffs seek to recover the full amount of the proceeds or, alternatively, the pro rata amount of proceeds attributable to insurance premiums that the employees and/or their beneficiaries paid directly to Anthem. Kentucky Retirement System believes that the claims are without merit and intends to vigorously defend its position. The ultimate outcome of this litigation cannot presently be determined. However, in management's opinion, the likelihood of a material adverse outcome is unlikely. Accordingly, adjustments, if any, that might result from the resolution of this matter have not been reflected in the financial statements.

#### **NOTE L--EXCHANGE GAIN OR LOSS**

Foreign currency translations resulted in an aggregate exchange gain of \$158,432,007 for the Pension Funds and \$21,586,901 for the Insurance Funds.

#### **NOTE M--DEFINED BENEFIT PENSION PLAN**

All eligible employees of Kentucky Retirement Systems (KRS) participate in the Kentucky Employees Retirement System (non-hazardous), a cost sharing, multiple employer defined pension plan that covers substantially all regular full-time employees in non-hazardous positions of any Kentucky State Department, Board or Agency directed by Executive Order to participate in the system. The Plan provides for retirement, disability, and death benefits to plan members. Plan benefits are extended to beneficiaries of plan members under certain circumstances. KRS contributed 3.76% of covered payroll for the period July 1, 2002 - December 15, 2002 and 5.89% for the period December 16, 2002 - June 30, 2003. For the year ended June 30, 2002, KRS contributed 5.89% of covered payroll. Plan members were required to contribute 5% of creditable compensation for the plan years ended June 30, 2003 and 2002. Covered payroll was approximately \$8,265,000 and \$7,521,000 for 2003 and 2002, respectively. KRS contributed approximately \$408,000 and \$443,000 for 2003 and 2002, respectively.

**KENTUCKY RETIREMENT SYSTEMS**

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2003 and 2002

**NOTE N--EQUIPMENT**

Equipment at June 30, 2003 and 2002 consists of the following:

Equipment, at cost	\$ 3,343,869	\$ 3,179,151
Less accumulated depreciation	<u>(2,332,240)</u>	<u>(1,980,185)</u>
	<u>\$ 1,011,629</u>	<u>\$ 1,198,966</u>

Depreciation expense for the years ended June 30, 2003 and 2002 amounted to \$352,054 and \$329,839, respectively.

**NOTE O--COLLATERALIZATION OF DEPOSITS**

At June 30, 2003, KRS had cash deposits at a financial institution, which totaled approximately \$1,709,000. The balance is insured by the Federal Deposit Insurance Corporation up to \$100,000. The remaining balance of approximately \$1,609,000 was collateralized by securities recorded in KRS's name and held by the financial institution.

**REQUIRED SUPPLEMENTARY INFORMATION**

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
<u>Non-Hazardous</u>						
June 30, 1998	4,356,072,625	3,800,014,746	(556,057,879)	1.146	1,321,004,266	(0.421)
June 30, 1999	5,264,340,397	4,327,622,821	(936,717,576)	1.216	1,330,766,100	(0.704)
June 30, 2000	6,806,675,460	4,876,825,772	(1,929,849,688)	1.396	1,409,504,668	(1.369)
June 30, 2001	6,844,742,687	5,444,035,294	(1,400,707,393)	1.257	1,505,299,220	(0.931)
June 30, 2002*	6,654,084,196	6,026,094,764	(627,989,432)	1.104	1,595,809,458	(0.393)
June 30, 2003**	6,351,318,832	6,520,463,188	169,144,356	0.974	1,658,604,696	0.102
<u>Hazardous</u>						
June 30, 1998	212,214,618	171,735,076	(40,479,542)	1.236	93,130,996	(0.435)
June 30, 1999	259,839,319	204,282,788	(55,556,531)	1.272	103,464,123	(0.537)
June 30, 2000	336,213,464	243,365,557	(92,847,907)	1.382	115,639,439	(0.803)
June 30, 2001	361,677,475	285,193,761	(76,483,714)	1.268	122,857,992	(0.623)
June 30, 2002*	376,384,302	322,069,164	(54,315,138)	1.169	125,275,925	(0.434)
June 30, 2003**	385,925,722	356,879,133	(29,046,589)	1.081	129,088,956	(0.225)

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
<u>Non-Hazardous</u>						
June 30, 1998	3,346,205,003	2,663,946,276	(682,258,727)	1.256	1,437,594,574	(0.475)
June 30, 1999	4,072,227,435	2,991,420,884	(1,080,806,551)	1.361	1,346,601,939	(0.803)
June 30, 2000	5,284,033,534	3,368,601,134	(1,915,432,400)	1.569	1,452,058,248	(1.319)
June 30, 2001	5,423,834,549	3,706,282,212	(1,717,552,337)	1.463	1,544,973,296	(1.112)
June 30, 2002*	5,397,787,158	4,165,355,149	(1,232,432,009)	1.296	1,663,183,629	(0.741)
June 30, 2003**	5,286,580,047	4,417,597,802	(868,982,245)	1.197	1,796,451,180	(0.484)
<u>Hazardous</u>						
June 30, 1998	927,057,492	865,966,626	(61,090,866)	1.071	236,180,023	(0.257)
June 30, 1999	1,124,651,486	963,711,775	(160,939,711)	1.167	256,201,726	(0.628)
June 30, 2000	1,445,542,794	1,084,553,697	(360,989,097)	1.333	288,575,870	(1.251)
June 30, 2001	1,486,666,016	1,193,860,442	(292,805,574)	1.245	316,700,304	(0.925)
June 30, 2002*	1,485,511,793	1,327,291,273	(158,220,520)	1.119	345,849,277	(0.457)
June 30, 2003**	1,467,004,856	1,499,628,782	32,623,926	0.978	374,700,732	0.087

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

**STATE POLICE RETIREMENT SYSTEM**

<u>Year Ended</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Entry Age Normal (b)</u>	<u>Overfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a % of Covered Payroll ((b-a)/c)</u>
June 30, 1998	306,318,918	294,427,019	(11,891,899)	1.040	38,727,361	(0.307)
June 30, 1999	357,623,196	314,021,673	(43,601,523)	1.139	40,433,405	(1.078)
June 30, 2000	459,168,574	336,579,763	(122,588,811)	1.364	43,619,383	(2.810)
June 30, 2001	456,160,709	356,211,860	(99,948,849)	1.281	44,646,678	(2.237)
June 30, 2002*	438,955,465	380,790,346	(58,165,119)	1.153	44,314,696	(1.312)
June 30, 2003**	413,063,576	414,881,459	1,817,883	0.996	43,760,832	0.042

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

KERS	Actuarial	Actuarial Accrued	Overfunded	Funded Ratio	Covered Payroll	UAAL as a
<u>Non-Hazardous</u>	Value of Assets	Liability (AAL)	AAL	(a/b)	(c)	% of Covered
	(a)	Entry Age Normal	(UAAL)			Payroll
		(b)	(b-a)			((b-a)/c)
June 30, 1998	210,105,184	1,242,183,993	1,032,078,809	0.169	1,321,004,266	0.781
June 30, 1999	283,704,887	1,273,364,800	989,659,913	0.223	1,330,766,100	0.743
June 30, 2000	399,560,252	1,457,475,358	1,057,915,106	0.274	1,409,504,668	0.751
June 30, 2001	449,630,605	1,769,583,098	1,319,952,493	0.254	1,505,299,220	0.877
June 30, 2002*	521,250,455	1,907,683,881	1,386,433,426	0.273	1,595,809,458	0.869
June 30, 2003**	553,885,082	2,093,210,321	1,539,325,239	0.265	1,658,604,696	0.928
<u>KERS</u>						
<u>Hazardous</u>						
June 30, 1998	54,606,786	137,394,162	82,787,376	0.397	93,130,996	0.889
June 30, 1999	74,579,649	149,158,586	74,578,937	0.500	103,464,123	0.721
June 30, 2000	102,212,237	175,167,613	72,955,376	0.584	115,639,439	0.631
June 30, 2001	119,372,742	214,450,822	95,078,080	0.557	122,857,992	0.774
June 30, 2002*	135,874,582	236,819,050	100,944,468	0.574	125,275,925	0.806
June 30, 2003**	151,459,500	283,178,335	131,718,835	0.535	129,088,956	1.020

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued



**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

CERS	Actuarial	Actuarial Accrued	Overfunded	Funded Ratio	Covered Payroll	UAAL as a
<u>Non-Hazardous</u>	<u>Value of Assets</u>	<u>Liability (AAL)</u>	<u>AAL</u>	<u>(a/b)</u>	<u>(c)</u>	<u>% of Covered</u>
	<u>(a)</u>	<u>Targeted Rate</u>	<u>(UAAL)</u>			<u>Payroll</u>
		<u>(b)</u>	<u>(b-a)</u>			<u>((b-a)/c)</u>
June 30, 1998	168,531,296	1,213,339,747	1,044,808,451	0.139	1,437,594,574	0.727
June 30, 1999	231,937,169	1,282,874,286	1,050,937,117	0.180	1,346,601,939	0.780
June 30, 2000	319,642,694	1,466,716,928	1,147,074,234	0.218	1,452,058,248	0.790
June 30, 2001	371,758,628	1,793,710,768	1,421,952,140	0.207	1,544,973,296	0.920
June 30, 2002*	450,497,307	1,977,577,038	1,527,079,731	0.228	1,663,183,629	0.918
June 30, 2003**	520,060,105	2,176,963,259	1,656,903,154	0.239	1,796,451,180	0.922
<u>CERS</u>						
<u>Hazardous</u>						
June 30, 1998	87,055,079	493,286,363	406,231,284	0.176	236,180,023	1.720
June 30, 1999	114,590,223	518,280,115	403,689,892	0.221	256,201,726	1.576
June 30, 2000	168,657,912	599,936,029	431,278,117	0.281	288,575,870	1.495
June 30, 2001	197,875,249	721,605,292	523,730,043	0.274	316,700,304	1.654
June 30, 2002*	234,683,878	781,184,974	546,501,096	0.301	345,849,279	1.580
June 30, 2003**	269,190,080	935,650,662	666,460,582	0.288	374,700,732	1.779

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

<u>SPRS</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Targeted Targeted Rate (b)</u>	<u>Overfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a % of Covered Payroll ((b-a)/c)</u>
June 30, 1998	41,410,500	124,501,076	83,090,576	0.333	38,727,361	2.146
June 30, 1999	53,929,859	125,797,150	71,867,291	0.429	40,433,405	1.777
June 30, 2000	71,711,712	138,867,085	67,155,373	0.516	43,619,383	1.540
June 30, 2001	79,863,577	158,261,479	78,397,902	0.505	44,646,678	1.756
June 30, 2002*	86,867,391	165,445,412	78,578,021	0.525	44,314,696	1.773
June 30, 2003**	90,747,967	184,501,205	93,753,238	0.492	43,760,832	2.142

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

**NON-HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	117,437,279	112,082,480	0.954
June 30, 1999	106,860,518	107,514,778	1.006
June 30, 2000	113,183,225	115,055,476	1.017
June 30, 2001	88,662,124	90,356,951	1.019
June 30, 2002	93,993,177	95,672,345	1.018
June 30, 2003	96,957,960	72,932,669	0.752

**HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	16,642,509	15,997,189	0.961
June 30, 1999	19,306,405	19,443,818	1.007
June 30, 2000	21,578,319	21,633,272	1.003
June 30, 2001	23,146,446	23,852,961	1.031
June 30, 2002	23,601,984	23,821,216	1.009
June 30, 2003	24,350,617	23,205,870	0.953

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

**NON-HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	124,351,931	107,490,256	0.864
June 30, 1999	109,074,757	110,591,016	1.014
June 30, 2000	105,709,840	106,587,217	1.008
June 30, 2001	97,951,307	111,206,820	1.135
June 30, 2002	105,445,842	107,678,891	1.021
June 30, 2003	110,720,684	111,090,537	1.003

**HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	44,142,046	42,297,090	0.958
June 30, 1999	46,526,233	48,290,617	1.037
June 30, 2000	50,645,065	51,739,272	1.022
June 30, 2001	51,558,809	53,132,792	1.031
June 30, 2002	56,304,262	56,785,282	1.009
June 30, 2003	63,422,978	62,149,506	0.980

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED

**STATE POLICE RETIREMENT SYSTEM**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	10,293,733	9,573,742	0.930
June 30, 1999	9,465,460	9,463,188	0.999
June 30, 2000	10,211,298	10,215,824	1.000
June 30, 2001	9,634,753	9,628,912	0.999
June 30, 2002	9,563,111	9,562,256	0.999
June 30, 2003	9,398,296	7,634,252	0.812

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

**KERS  
NON-HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	54,029,074	39,503,545	0.731
June 30, 1999	56,690,636	56,769,539	1.001
June 30, 2000	76,818,004	76,926,320	1.001
June 30, 2001	66,874,871	66,874,871	1.000
June 30, 2002	93,993,177	93,912,017	0.999
June 30, 2003	92,052,561	65,335,219	0.710

**KERS  
HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	9,341,039	6,632,037	0.710
June 30, 1999	10,760,269	10,773,916	1.001
June 30, 2000	12,026,502	12,047,095	1.002
June 30, 2001	13,226,298	13,226,298	1.000
June 30, 2002	15,859,932	15,887,399	1.002
June 30, 2003	15,839,215	15,883,263	1.003

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

**CERS  
NON-HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	48,303,178	29,271,074	0.606
June 30, 1999	47,939,029	47,901,837	0.999
June 30, 2000	55,033,008	55,213,973	1.003
June 30, 2001	62,292,385	62,292,385	1.000
June 30, 2002	102,119,475	102,150,543	1.000
June 30, 2003	102,038,427	99,234,843	0.973

**CERS  
HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	20,783,842	14,275,040	0.687
June 30, 1999	23,647,419	23,382,957	0.989
June 30, 2000	27,991,859	28,345,377	1.013
June 30, 2001	32,149,432	32,149,432	1.000
June 30, 2002	45,721,274	45,730,333	1.000
June 30, 2003	43,502,755	45,243,950	1.040

Continued

**KENTUCKY RETIREMENT SYSTEMS**

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<b>SPRS</b>	
		<b><u>HAZARDOUS</u></b>	
		<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	5,909,401	5,125,678	0.867
June 30, 1999	6,808,270	5,120,037	0.752
June 30, 2000	7,237,579	7,251,787	1.002
June 30, 2001	7,807,870	7,817,613	1.001
June 30, 2002	8,098,907	8,113,391	1.002
June 30, 2003	9,443,588	7,654,313	0.811



## KENTUCKY RETIREMENT SYSTEMS

### NOTES TO REQUIRED SUPPLEMENTARY 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:

#### PENSION FUNDS

	<u>Non-Hazardous</u>	<u>Hazardous</u>
Valuation Date	June 30, 2003	June 30, 2003
Actuarial Cost Method	Entry Age Normal	Entry Age Normal
Amortization Method	Level Percent Closed	Level Percent Closed
Amortization Period - Each Benefit Improvement	30 years – Commencing with 1990 Valuation	30 years – Commencing with 1990 Valuation
Asset Valuation Method	Five-year Smoothing of Investment Gains and Losses	Five-year Smoothing of Investment Gains and Losses
Postretirement Benefit Increase	2.85%	2.85%
Actuarial Assumptions:		
Investment Return	8.25%	8.25%
Projected Salary Increases	6.50%	6.50%
Inflation Rate	3.50%	3.50%

#### POST-EMPLOYMENT HEALTHCARE

	<u>Non-Hazardous</u>	<u>Hazardous</u>
Valuation Date	June 30, 2003	June 30, 2003
Actuarial Cost Method	Targeted Rate	Targeted Rate
Asset Valuation Method - Started with 1996 Valuation	Five-year Smoothing of Investment Gains and Losses	Five-year Smoothing of Investment Gains and Losses
Actuarial Assumptions:		
Investment Return	8.25%	8.25%
Projected Salary Increases	6.50%	6.50%
Inflation Rate	3.50%	3.50%

**ADDITIONAL SUPPORTING SCHEDULES**

## KENTUCKY RETIREMENT SYSTEMS

### SCHEDULE OF ADMINISTRATIVE EXPENSES

Years Ended June 30, 2003 and 2002

(Dollars in thousands)

	<u>2003</u>	<u>2002</u>
<b>Personal Services</b>		
Salaries and per diem	\$ 8,681	\$ 7,702
Fringe benefits	1,679	1,574
Tuition assistance	<u>45</u>	<u>36</u>
<b>Total personal services</b>	10,405	9,312
<b>Contractual Services</b>		
Actuarial	66	36
Audit	59	28
Legal	575	246
Medical	211	139
Contractual	<u>452</u>	<u>348</u>
<b>Total contractual services</b>	1,363	797
<b>Communication</b>		
Printing	142	143
Telephone	134	121
Postage	337	685
Travel	<u>168</u>	<u>135</u>
<b>Total communication</b>	781	1,084
<b>Rentals</b>		
Office space	814	512
Equipment	<u>52</u>	<u>43</u>
<b>Total rentals</b>	866	555
<b>Miscellaneous</b>		
Utilities	101	66
Supplies	123	177
Insurance	48	36
Maintenance	225	199
Other	<u>166</u>	<u>47</u>
<b>Total miscellaneous</b>	663	525
<b>Depreciation</b>	352	330
<b>Healthcare Administrative Fees</b>	<u>862</u>	<u>778</u>
<b>Total Administrative Expenses</b>	<u>\$ 15,292</u>	<u>\$ 13,381</u>

## KENTUCKY RETIREMENT SYSTEMS

### SCHEDULE OF INVESTMENT EXPENSES

Years Ended June 30, 2003 and 2002

(Dollars in thousands)

	<u>2003</u>	<u>2002</u>
<b>RETIREMENT FUNDS</b>		
<b>Security Lending Fees</b>		
Broker rebates	\$ 29,191	\$ 47,021
Lending agent fees	<u>1,554</u>	<u>2,964</u>
<b>Total security lending</b>	30,745	49,985
<b>Common Stock Commissions</b>	3,101	3,990
<b>Contractual Services</b>		
Investment management	6,609	6,704
Security custody	591	461
Investment consultant	<u>185</u>	<u>130</u>
<b>Total contractual services</b>	7,385	7,295
<b>INSURANCE FUNDS</b>		
<b>Security Lending Fees</b>		
Broker rebates	2,286	3,325
Lending agent fees	<u>140</u>	<u>186</u>
<b>Total security lending</b>	2,426	3,511
<b>Common Stock Commissions</b>	378	430
<b>Investment Management</b>	<u>522</u>	<u>451</u>
<b>Total investment expenses</b>	<u>\$ 44,557</u>	<u>\$ 65,662</u>

Information on fees paid to investment professionals can be found in the investment section of the Comprehensive Annual Financial Report.

**KENTUCKY RETIREMENT SYSTEMS**

**SCHEDULE OF PROFESSIONAL CONSULTANT FEES**

Years Ended June 30, 2003 and 2002

(Dollars in thousands)

	<u>2003</u>	<u>2002</u>
Actuarial Services	\$ 66	\$ 36
Medical Review Services	211	139
Audit Services	59	28
Legal Counsel	<u>575</u>	<u>246</u>
Total	<u>\$ 911</u>	<u>\$ 449</u>

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

Board of Trustees  
Kentucky Retirement Systems  
Frankfort, Kentucky

We have audited the financial statements of Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2003, and have issued our report thereon dated September 18, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Kentucky Retirement Systems' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Kentucky Retirement Systems' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the management of Kentucky Retirement Systems in a separate letter dated September 18, 2003.

This report is intended for the information of the audit committee, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

September 18, 2003  
Louisville, Kentucky