

KENTUCKY RETIREMENT SYSTEMS

Financial Statements and Supplementary Information

*For the Fiscal Years Ended June 30, 2009 and 2008
With Independent Auditors' Report Thereon*



CONTENTS

Pages

Independent Auditors' Report.....	1-2	
Management's Discussion and Analysis	3-9	
Financial Statements:		
Combined Statement of Plan Net Assets-Pension Funds.....	10	
Combined Statement of Changes in Plan Net Assets-Pension Funds	11-12	
Combined Statement of Plan Net Assets-Insurance Fund	13	
Combined Statement of Changes in Plan Net Assets-Insurance Fund	14-15	
Notes to the Financial Statements.....	16-52	
Required Supplementary Information:		
Schedule of Funding Progress:		
Kentucky Employees Retirement System-Pension Funds.....	53	
County Employees Retirement System-Pension Funds.....	54	
State Police Retirement System-Pension Funds	55	
Kentucky Employees Retirement System-Insurance Fund	56	
County Employees Retirement System-Insurance Fund	57	
State Police Retirement System-Insurance Fund	58	
Schedule of Contributions from Employers and Other Contributing Entities:		
Kentucky Employees Retirement System	59-60	
County Employees Retirement System	61-62	
State Police Retirement System	63	
Additional Supporting Schedules:		
Schedule of Administrative Expenses.....	64	
Schedule of Investment Expenses.....	65	
Schedule of Professional Consultant Fees	66	
Report On Internal Control Over Financial Reporting and On Compliance And Other Matters Based On An Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>		67-68
Schedule of Findings and Response	69	

DEAN DORTON | FORD
LLP

Independent Auditors' 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 fiscal years ended June 30, 2009 and 2008, 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.

We conducted our audits 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 audits provide 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, 2009 and 2008, and the changes in plan net assets for the fiscal years 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 November 10, 2009, on our consideration of the Kentucky Retirement Systems' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis (pages 3 through 9) and the Schedule of Funding Progress and Schedule of Contributions from Employers and Other Contributing Entities (pages 53 through 63) 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 required supplementary information. However, we did not audit the information and express no opinion on it.

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Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional supporting schedules (pages 64 through 66) are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

November 10, 2009
Lexington, Kentucky



KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis

June 30, 2009

This discussion and analysis of Kentucky Retirement Systems' financial performance provides an overview of the pension and insurance fund financial activities for the fiscal year ended June 30, 2009. Please read it in conjunction with the financial statements, which begin on page 10.

Financial Highlights-Pension Funds

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 decreased by \$3,073,688,450 during fiscal 2009.
- Member and Employer contributions reported for fiscal 2009, totaled \$685,589,301 compared to \$654,695,129 in fiscal 2008. This increase is due to an increase in the covered payroll reported (in the case of the CERS Non-Hazardous plan), an increase in the employer contribution rates, and the collection of additional health insurance contributions passed by House Bill 1 in September 2008. Member contributions decreased \$13,417,992 due to a decrease in service purchases which have become more expensive as a result of the passage of House Bill 1.
- The net depreciation in the fair value of investments was \$2,538,596,591 for the fiscal year ended June 30, 2009 compared to net depreciation of \$997,367,356 for the prior fiscal year. Included in this net depreciation were realized losses on sales of investments of \$750,132,021. In comparison, the pension funds realized gains of \$360,063,389 for the fiscal year ended June 30, 2008. The decrease in realized gains experienced by the pension funds is due to unfavorable market conditions.
- Interest, dividend and securities lending income was \$350,470,742 compared to \$558,997,536 in last fiscal year.
- Pension benefits paid to retirees and beneficiaries totaled \$1,478,730,332. Refund of contributions paid to former members upon termination of employment totaled \$23,627,909.
- Administrative expense totaled \$23,970,064 compared to \$22,907,272 in the prior fiscal year.
- The member health insurance contribution, as a result of the passage of House Bill 1 (effective September 1, 2008) totaled \$898,946, for the ten months ended June 30, 2009.
- An impairment totaling \$39,279,421 was incurred during fiscal 2009. This was for unrealized losses associated with KRS' participation in the securities lending program at Northern Trust (the custodial bank of KRS).

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2009

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 decreased by \$591,649,232 during fiscal 2009.
- Premiums received from retirees who participated in the Medicare eligible self-funded plan totaled \$27,121,929.
- Employer contributions of \$297,194,679 were received compared to \$372,294,824 in fiscal 2008. This decrease is due to a decrease in the insurance contribution rate.
- Retiree drug subsidies totaled \$16,834,869 compared to \$13,313,947 in fiscal 2008.
- The net depreciation in the fair value of investments was \$656,699,368 compared to net depreciation of \$282,385,971 for the prior fiscal year. Included in this net depreciation were realized losses on sales of investments of \$205,178,412. In comparison, the insurance fund realized gains on investments of \$104,964,501 in the prior fiscal year. This decrease in realized gains is due to unfavorable market conditions.
- Interest, dividend and securities lending income was \$52,228,249 compared to income of \$93,315,951 in fiscal 2008. This decrease was due to unfavorable market conditions.
- Premiums paid by the fund for hospital and medical insurance coverage (under age 65) totaled \$198,272,571. Payments for the self-funded healthcare reimbursements (over age 65) totaled \$114,554,929. The total of insurance premiums paid plus self-funded reimbursements was \$312,827,500 for fiscal 2009. Insurance premiums paid plus self-funded healthcare reimbursements for the prior plan year totaled \$269,351,915.
- As part of the application process to the Centers for Medicare & Medicaid Services to enter into a contract to offer a Medicare Prescription Drug Plan, KRS was required to establish a segregated Insolvency Account in the amount of \$100,000; this account must retain a minimum balance of \$100,000. The account consists of cash and/or cash equivalents, and is invested on a daily basis.
- The reimbursement of retired-reemployed health insurance, as a result of the passage of House Bill 1 (effective September 1, 2008) totaled \$206,859 for the ten months ended June 30, 2009.
- An impairment totaling \$8,984,210 was incurred in fiscal 2009. This was for unrealized losses associated with KRS' participation in the securities lending program at Northern Trust (the custodial bank of KRS).

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2009

Using This Financial Report

Because of the long-term nature of a defined benefit pension plan and post-employment healthcare benefit plan, the 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 Statement of Plan Net Assets for the Pension Funds, on page 10, and the Combined Statement of Plan Net Assets for the Insurance Fund, on page 13, provide a snapshot of the financial position of each of the three systems at June 30, 2009. The Combined Statement of Changes in Plan Net Assets for the Pension Funds, on pages 11-12, and the Combined Statement of Changes in Plan Net Assets for the Insurance Fund, on pages 14-15, summarize the additions and deductions that occurred for each of the three systems during fiscal 2009.

The Schedule of Funding Progress, on pages 53-58, 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 Contributions from Employers and Other Contributing Entities, on pages 59-63, presents historical trend information about the annual required contributions and the contributions made 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

Management's Discussion and Analysis, continued

June 30, 2009

Kentucky Retirement Systems As A Whole

Kentucky Retirement Systems' combined plan net assets decreased, during the fiscal year ended June 30, 2009, by \$3,665.4 million from \$15,603.3 million to \$11,937.9 million. Plan net assets for the prior fiscal year decreased by \$1,356.1 million. The decrease in plan net assets for the plan year ended June 30, 2009 is primarily attributable to overall losses in the stock market. The resultant decrease in net plan assets is particularly significant in the KERS Non-Hazardous and State Police plans, which show a negative cash flow where \$1,025.2 million in benefits, refunds and expenses were paid out and net investment earnings showed a loss of \$765 million. The analysis below focuses on plan net assets (Table 1) and changes in plan net assets (Table 2) of Kentucky Retirement Systems' Pension and Insurance Funds.

Table 1
Plan Net Assets
(In Millions)

	Pension Funds			Insurance Fund			Total		
	2009	2008	2007	2009	2008	2007	2009	2008	2007
Cash & Invest Receivables	\$ 11,645.5	\$ 15,768.8	\$ 17,245.3	\$ 2,460.2	\$ 3,379.9	\$ 3,441.6	\$ 14,105.7	\$ 19,148.7	\$ 20,686.9
Equip/Int Assets, net of deprec/amort.	113.9	122.4	125.2	38.7	45.5	41.4	152.6	167.9	166.6
Total Assets	11,767.5	15,899.7	17,372.4	2,498.9	3,425.4	3,483.0	14,266.4	19,325.1	20,855.4
Total Liabilities	(1,885.8)	(2,944.3)	(3,144.2)	(142.7)	(777.5)	(751.8)	(2,328.5)	(3,721.8)	(3,896.0)
Plan Net Assets	\$ 9,881.7	\$ 12,955.4	\$ 14,228.2	\$ 2,056.2	\$ 2,647.9	\$ 2,731.2	\$ 11,937.9	\$ 15,603.3	\$ 16,959.4

Table 2
Changes in Plan Net Assets
(In Millions)

	Pension Funds			Insurance Fund			Total		
	2009	2008	2007	2009	2008	2007	2009	2008	2007
Additions:									
Member Cont.	\$ 290.8	\$ 304.3	\$ 300.3	\$ -	\$ -	\$ -	\$ 290.8	\$ 304.3	\$ 300.3
Employer Cont.	393.8	350.4	293.4	297.2	372.3	307.7	691.0	722.7	601.1
Health Ins. Cont.	0.9						0.9		
Premiums Rec'd				27.1	28.5	26.6	27.1	28.5	26.6
Retired Remp Ins.				0.2			0.2		
Medicare Subsidy				16.8	13.3	21.5	16.8	13.3	21.5
Invest Inc. (net)	(2,232.9)	(579.9)	1,915.8	(611.3)	(220.6)	423.4	(2,844.2)	(800.5)	2,339.2
Total Additions	(1,547.4)	74.8	2,509.5	(270.0)	193.5	779.2	(1,817.4)	265.3	3,288.7
Deductions:									
Benefit payments	1,478.7	1,299.2	1,187.1				1,478.7	1,299.2	1,187.1
Refunds	23.6	25.5	25.2				23.6	25.5	25.2
Administrative Ex.	24.0	22.9	21.3	8.8	7.5	6.7	32.8	30.4	27.8
Healthcare Costs				312.9	269.3	241.1	312.9	269.3	241.1
Demut. Refund						0.8			0.8
Total Deductions	1,526.3	1,347.6	1,233.4	321.7	276.8	248.6	1,848.0	1,624.4	1,482.0
Inc. (Decrease) In Plan Net Assets	\$ (3,073.7)	\$ (1,272.8)	\$ 1,276.1	\$ (591.7)	\$ (83.3)	\$ 530.6	\$ (3,665.4)	\$ (1,356.1)	\$ 1,806.7

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2009

Kentucky Retirement Systems As A Whole, continued

Plan net assets of the pension funds decreased by \$3,073.7 million (\$9,881.7 million compared to \$12,955.4 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 assets decrease is attributable primarily to the overall losses in the fair value of investments due to adverse market conditions.

Plan net assets of the insurance fund decreased by approximately \$591.7 million (\$2,056.2 million compared to \$2,647.9 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 decrease in net plan assets is primarily attributable to the overall losses in the fair value of investments, which is due to adverse market conditions.

Pension Fund Activities

Member contributions decreased by \$13.5 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. The decrease in member contributions is a result of a decrease in elective service purchases by Kentucky Retirement Systems' members over the prior period.

Employer contributions increased by \$43.5 million due to the increase in covered payroll reported to Kentucky Retirement Systems (in the case of the CERS Non-Hazardous plan) and the increase in the employer contribution rate applied to covered payroll.

Net investment income decreased by \$1,653 million (net investment loss of \$2,232.9 million compared to net investment loss of \$579.9 million in the prior year). The pension funds experienced a decrease in income primarily due to the decrease in gains on sale of investments. This can be illustrated in Table 3 as follows:

Investment Income (Loss) -Pension	In Millions		
	2009	2008	2007
(Decrease) increase in fair value of investments	\$ (1,788)	\$ (1,357)	\$ 638
Investment income net of investment expense	305	417	408
(Loss) gain on sale of investments	(750)	360	870
Net investment income (loss)	<u>\$ (2,233)</u>	<u>\$ (580)</u>	<u>\$ 1,916</u>

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2009

Pension Fund Activities, continued

Pension fund deductions increased by \$178.8 million caused principally by an increase of \$179.6 million in benefit payments. Retirees received a Cost of Living Adjustment (COLA) increase of 2.8% in benefit payments as of July 1, 2008. Refunds of member contributions decreased by \$1.8 million and administrative expenses increased by \$1.1 million.

Insurance Fund Activities

Employer contributions paid into the insurance fund decreased by \$75.1 million over the prior fiscal year. This decrease is a result of the decrease in the employer contribution rate applied to covered payroll.

Net investment income decreased by \$390.9 million. This decrease in net income is due primarily to the decrease in the gains on sale of investments. This can be illustrated in Table 4 as follows:

Investment Income (Loss)-Insurance	In Millions		
	2009	2008	2007
(Decrease) increase in fair value of investments	\$ (451)	\$ (387)	\$ 237
Investment income net of investment expense	45	62	56
(Loss) gain on sale of investments	(205)	105	130
Net investment income (loss)	<u>\$ (611)</u>	<u>\$ (220)</u>	<u>\$ 423</u>

Insurance fund deductions increased by \$44.9 million due to the increase in overall healthcare costs.

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2009

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 and Insurance Funds is provided in the Schedule of Funding Progress on pages 53-58. 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. This actuarial accrued liability is the measure of the cost of benefits that have been earned to date by Kentucky Retirement Systems' members, but not yet paid. The difference in value between the actuarial accrued liability and the actuarial value of assets is defined as the unfunded actuarial accrued liability.

The unfunded actuarial accrued liability in the pension plans increased by \$2,009.3 million for a total unfunded amount of \$9,397.2 million for the fiscal year ended June 30, 2009, compared to an unfunded amount of \$7,387.9 million for the fiscal year ended June 30, 2008. In recent years, funding levels for the pension funds have fallen dramatically in response to investment returns less than the actuarially assumed rate, higher than anticipated retirement rates, and expenditures for unfunded retiree Cost of Living Adjustments. Within the KERS and SPRS plans, employer contribution rate reductions enacted by the Kentucky General Assembly have limited the plans ability to correct the declining funding levels.

The insurance plan's unfunded actuarial accrued liability for the plan year ended June 30, 2009, decreased to \$7,199.3 million from \$8,973.5 million for the plan year ended June 30, 2008. This is a decrease in the unfunded actuarial accrued liability of \$1,774.2 million. This reduction is the result of the recent adoption of new actuarial assumptions and KRS' adoption of an Employer Group Waiver Plan (EGWP) in connection with its Medicare eligible drug program, which allows KRS to apply monetary reimbursements from the Center for Medicare and Medicaid Services to reduce unfunded actuarial liabilities.

Annual required contributions of the employers as actuarially determined and actual contributions made by employers and other contributing entities in relation to the required contributions are provided in the Schedule of Contributions from Employers and Other Contributing Entities on pages 59-63. The difference in the annual required contributions and actual contributions made by employers and other contributing entities in the KERS and SPRS funds is attributable to the statutory employer contribution rate set by the Kentucky General Assembly being less than the rate computed by the actuary.

KENTUCKY RETIREMENT SYSTEMS

Combined Statement of Plan Net Assets-Pension Funds

As of June 30, 2009 (with Comparative Totals As of June 30, 2008)

(Dollars in Thousands)

	2009					2008	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
ASSETS							
Cash and Short-Term Investments							
Cash	\$ 106	\$ 264	\$ 111	\$ 268	\$ 103	\$ 852	\$ 969
Short-Term Investments	86,443	199,920	203,131	495,768	32,171	1,017,433	199,793
Total Cash and Short-Term Investments	86,549	200,184	203,242	496,036	32,274	1,018,285	200,762
Receivables							
Contributions	1,494	20,802	11,880	35,939	1,040	71,155	68,160
Investment Income	1,415	16,690	5,207	18,383	1,147	42,842	54,249
Total Receivables	2,909	37,492	17,087	54,322	2,187	113,997	122,409
Investments, at fair value							
Corporate and Government Bonds	75,234	895,494	282,141	1,011,886	64,905	2,329,660	3,284,259
Corporate Stocks	194,094	2,119,414	711,815	2,387,299	133,347	5,545,969	7,995,916
Mortgages	31,063	331,383	112,451	398,781	24,739	898,417	1,343,960
Real Estate	2,150	4,349	3,121	4,703	623	14,946	9,545
Total Investments, at fair value	302,541	3,350,640	1,109,528	3,802,669	223,614	8,788,992	12,633,680
Securities Lending Collateral Invested	72,600	667,843	245,246	804,609	47,879	1,838,177	2,934,343
Equipment (net of accumulated depreciation)	178	2,075	309	3,556	37	6,155	6,398
Intangible Assets (net of accumulated amortization)	54	648	96	1,104	11	1,913	2,139
Total Assets	464,831	4,258,882	1,575,508	5,162,296	306,002	11,767,519	15,899,731
LIABILITIES							
Accounts Payable	334	3,335	668	3,895	134	8,366	10,005
Securities Lending Collateral	72,600	667,843	245,246	804,609	47,879	1,838,177	2,934,343
Impairment-Securities Lending	2,946	3,103	9,034	22,782	1,314	39,279	
Total Liabilities	75,880	674,281	254,948	831,286	49,427	1,885,822	2,944,348
Plan Net Assets Held in Trust for Pension Benefits	\$ 388,951	\$ 3,584,601	\$ 1,320,560	\$ 4,331,010	\$ 256,575	\$ 9,881,697	\$ 12,955,383

See accompanying notes to the financial statements.

KENTUCKY RETIREMENT SYSTEMS

Combined Statement of Changes in Plan Net Assets-Pension Funds

For the Fiscal Year Ended June 30, 2009 (with Comparative Totals For the Fiscal Year Ended June 30, 2008)

(Dollars in Thousands)

	2009					2008	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
ADDITIONS							
Members' Contributions	\$ 12,442	\$ 108,362	\$ 42,582	\$ 122,518	\$ 4,938	\$ 290,842	\$ 304,259
Employers' Contributions	15,843	112,383	78,151	179,286	8,186	393,849	350,435
Health Insurance Contributions (HB1)	38	404	37	415	5	899	
Total Contributions	28,323	221,149	120,770	302,219	13,129	685,590	654,694
INVESTMENT INCOME							
From Investing Activities:							
Net Depreciation in							
Fair Value of Investments	(95,459)	(981,576)	(342,163)	(1,060,080)	(59,319)	(2,538,597)	(997,369)
Interest/Dividends	11,334	116,332	39,736	134,548	8,290	310,240	418,802
Total Investing Activities Loss	(84,125)	(865,244)	(302,427)	(925,532)	(51,029)	(2,228,357)	(578,567)
Investment Expense	468	5,332	1,540	5,616	345	13,301	12,750
Commissions	337	3,156	1,039	3,572	238	8,342	7,915
Total Investing Activities Expense	805	8,488	2,579	9,188	583	21,643	20,665
Net Loss from Investing Activities	(84,930)	(873,732)	(305,006)	(934,720)	(51,612)	(2,250,000)	(599,232)
From Securities Lending Activities:							
Securities Lending Income	1,583	14,479	5,350	17,778	1,041	40,231	140,195
Securities Lending Expense:							
Security Borrower Rebates	770	7,084	2,601	8,535	508	19,498	115,960
Security Lending Agent Fees	145	1,338	491	1,613	96	3,683	4,950
Net Income from Securities Lending Activities	668	6,057	2,258	7,630	437	17,050	19,285
Total Net Investment Loss	(84,262)	(867,675)	(302,748)	(927,090)	(51,175)	(2,232,950)	(579,947)
Total (Loss) Additions	(55,939)	(646,526)	(181,978)	(624,871)	(38,046)	(1,547,360)	74,747

KENTUCKY RETIREMENT SYSTEMS

Combined Statement of Changes in Plan Net Assets-Pension Funds, continued

For the Fiscal Year Ended June 30, 2009 (with Comparative Totals For the Fiscal Year Ended June 30, 2008)

(Dollars in Thousands)

	2009					2008	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
DEDUCTIONS							
Benefit Payments	\$ 37,556	\$ 808,513	\$ 138,810	\$ 451,304	\$ 42,547	\$ 1,478,730	\$ 1,299,174
Refunds	1,277	9,127	2,436	10,719	69	23,628	25,468
Administrative Expenses	715	8,102	1,198	13,831	122	23,968	22,906
Total Deductions	<u>39,548</u>	<u>825,742</u>	<u>142,444</u>	<u>475,854</u>	<u>42,738</u>	<u>1,526,326</u>	<u>1,347,548</u>
Net Decrease in Plan Assets	(95,487)	(1,472,268)	(324,422)	(1,100,725)	(80,784)	(3,073,686)	(1,272,801)
Plan Net Assets Held in Trust for Pension Benefits							
Beginning of Year	<u>484,438</u>	<u>5,056,869</u>	<u>1,644,982</u>	<u>5,431,735</u>	<u>337,359</u>	<u>12,955,383</u>	<u>14,228,184</u>
End of Year	<u>\$ 388,951</u>	<u>\$ 3,584,601</u>	<u>\$ 1,320,560</u>	<u>\$ 4,331,010</u>	<u>\$ 256,575</u>	<u>\$ 9,881,697</u>	<u>\$ 12,955,383</u>

See accompanying notes to the financial statements.

KENTUCKY RETIREMENT SYSTEMS

Combined Statement of Plan Net Assets-Insurance Fund

As of June 30, 2009 (with Comparative Totals As of June 30, 2008)

(Dollars in Thousands)

	2009					2008	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
ASSETS							
Cash and Short-Term Investments							
Cash	\$ 23	\$ 57	\$ 17	\$ 79	\$ 4	\$ 180	\$ 221
Short-Term Investments	47,414	85,346	131,383	213,453	17,526	495,122	306,845
Medicare Drug Deposit	<u>11</u>	<u>20</u>	<u>23</u>	<u>41</u>	<u>5</u>	<u>100</u>	<u>100</u>
Total Cash and Short-Term Investments	47,448	85,423	131,423	213,573	17,535	495,402	307,066
Receivables							
Contributions	1,059	7,778	6,126	16,346	454	31,763	37,263
Investment Income	753	1,317	1,549	2,936	338	6,893	8,252
Loan Interest Receivable (Holly Hill)	<u>13</u>	<u>13</u>	<u>33</u>	<u>54</u>	<u>6</u>	<u>119</u>	<u>119</u>
Total Receivables	1,825	9,108	7,708	19,336	798	38,775	45,515
Investments, at fair value							
Corporate and Government Bonds	19,688	34,291	48,985	90,515	9,825	203,304	330,535
Corporate Stocks	151,587	240,585	297,692	576,137	65,960	1,331,961	1,968,330
Alternative Investment	15	15	37	61	7	135	135
Real Estate	<u>64</u>	<u>113</u>	<u>139</u>	<u>256</u>	<u>28</u>	<u>600</u>	<u>600</u>
Total Investments	171,354	275,004	346,853	666,969	75,820	1,536,000	2,299,000
Security Lending Collateral Invested	<u>46,177</u>	<u>76,048</u>	<u>100,868</u>	<u>186,022</u>	<u>19,716</u>	<u>428,831</u>	<u>773,837</u>
Total Assets	<u>266,804</u>	<u>445,583</u>	<u>586,852</u>	<u>1,085,900</u>	<u>113,869</u>	<u>2,499,008</u>	<u>3,425,418</u>
LIABILITIES							
Accounts Payable	94	2,326	227	2,198	76	4,921	3,661
Securities Lending Collateral Obligations	46,177	76,048	100,868	186,022	19,716	428,831	773,837
Impairment-Securities Lending	<u>1,033</u>	<u>1,842</u>	<u>2,524</u>	<u>3,190</u>	<u>395</u>	<u>8,984</u>	<u>8,984</u>
Total Liabilities	<u>47,304</u>	<u>80,216</u>	<u>103,619</u>	<u>191,410</u>	<u>20,187</u>	<u>442,736</u>	<u>777,498</u>
Plan Net Assets Held in Trust for							
Insurance Benefits	\$ <u>219,500</u>	\$ <u>365,367</u>	\$ <u>483,233</u>	\$ <u>894,490</u>	\$ <u>93,682</u>	\$ <u>2,056,272</u>	\$ <u>2,647,920</u>

See accompanying notes to the financial statements.

KENTUCKY RETIREMENT SYSTEMS

Combined Statement of Changes in Plan Net Assets-Insurance Fund

For the Fiscal Year Ended June 30, 2009 (with Comparative Totals For the Fiscal Year Ended June 30, 2008)

(Dollars in Thousands)

	2009					2008	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
ADDITIONS							
Employers' Contributions	\$ 20,803	\$ 74,434	\$ 70,783	\$ 123,761	\$ 7,414	\$ 297,195	\$ 372,294
Retiree Drug Subsidy	186	8,168	628	7,624	229	16,835	13,315
Premiums Received from Retirees	296	12,211	328	14,264	23	27,122	28,522
Retired Reemployed Healthcare (HB1)	4	109	2	92		207	
Total Contributions	21,289	94,922	71,741	145,741	7,666	341,359	414,131
INVESTMENT INCOME							
From Investing Activities:							
Net Depreciation in							
Fair Value of Investments	(65,502)	(163,532)	(133,716)	(263,645)	(30,304)	(656,699)	(282,385)
Interest/Dividends	4,722	8,651	9,937	18,883	2,090	44,283	60,962
Interest Income (Holly Hill)	13	13	33	54	6	119	
Total Loss from Investing Activities	(60,767)	(154,868)	(123,746)	(244,708)	(28,208)	(612,297)	(221,423)
Investment Activities Expense	120	371	278	555	59	1,383	1,796
Commissions	103	204	201	375	46	929	1,249
Total Investing Activities Expense	223	575	479	930	105	2,312	3,045
Net Loss from Investing Activities	(60,990)	(155,443)	(124,225)	(245,638)	(28,313)	(614,609)	(224,468)
From Securities Lending Activities:							
Securities Lending Income	849	1,373	1,857	3,506	360	7,945	32,354
Securities Lending Expense:							
Security Borrower Rebates	425	701	929	1,715	181	3,951	27,476
Security Lending Agent Fees	75	123	164	301	32	695	1,008
Net Income from Securities Lending Activities	349	549	764	1,490	147	3,299	3,870
Total Net Investment Loss	(60,641)	(154,894)	(123,461)	(244,148)	(28,166)	(611,310)	(220,598)
Total (Loss) Additions	(39,352)	(59,972)	(51,720)	(98,407)	(20,500)	(269,951)	193,533

KENTUCKY RETIREMENT SYSTEMS

Combined Statement of Changes in Plan Net Assets-Insurance Fund, continued

For the Fiscal Year Ended June 30, 2009 (with Comparative Totals For the Fiscal Year Ended June 30, 2008)

(Dollars in Thousands)

	2009					2008	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
DEDUCTIONS							
Healthcare Premiums Subsidies	\$ 9,187	\$ 89,542	\$ 37,184	\$ 56,355	\$ 6,005	\$ 198,273	\$ 167,748
Administrative Fees	144	4,104	444	4,053	124	8,869	7,477
Self Funding Insurance Costs	<u>1,117</u>	<u>55,494</u>	<u>3,833</u>	<u>52,640</u>	<u>1,471</u>	<u>114,555</u>	<u>101,605</u>
Total Deductions	<u>10,448</u>	<u>149,140</u>	<u>41,461</u>	<u>113,048</u>	<u>7,600</u>	<u>321,697</u>	<u>276,830</u>
Net Decrease in Plan Assets	(49,800)	(209,112)	(93,181)	(211,455)	(28,100)	(591,648)	(83,297)
Plan Net Assets Held in Trust for Insurance Benefits							
Beginning of Year	<u>269,300</u>	<u>574,479</u>	<u>576,414</u>	<u>1,105,945</u>	<u>121,782</u>	<u>2,647,920</u>	<u>2,731,217</u>
End of Year	<u>\$ 219,500</u>	<u>\$ 365,367</u>	<u>\$ 483,233</u>	<u>\$ 894,490</u>	<u>\$ 93,682</u>	<u>\$ 2,056,272</u>	<u>\$ 2,647,920</u>

See accompanying notes to the financial statements.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements

GENERAL

Under the provisions of Kentucky Revised Statute Section 61.645, the Board of Trustees (the Board) 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 (the Board) 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). The assets of the insurance fund 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 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. Administrative and Investment Expenses are recognized when incurred.

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.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE A-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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. Improvements, which increase the useful life of the equipment, are capitalized. Maintenance and repairs are charged to expense as incurred. The capitalization threshold used in fiscals 2009 and 2008 was \$3,000 (see Note J for further information).

Intangible Assets

Intangible assets, currently computer software, are valued at historical cost and amortization is computed utilizing the straight-line method over the estimated useful lives of the assets which is ten years. The capitalization threshold used in fiscals 2009 and 2008 was \$3,000 (see Note K for further information).

Reclassification

Certain 2008 amounts have been reclassified to conform with 2009 presentation with no effect on net assets or changes in net assets.

Expense Allocation

Administrative and investment expenses of KRS are allocated in proportion to the number of active members participating in each plan and the carrying value of plan investments, respectively.

Component Unit

KRS is a component unit of the Commonwealth of Kentucky for financial reporting purposes.

The Kentucky Employees Retirement System (KERS) was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 61.515. The County Employees Retirement System (CERS) was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 78.520. The State Police Retirement System (SPRS) was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 16.510. The Kentucky Retirement Systems Insurance Fund was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 61.701. KRS' 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 KRS Board of Trustees without further legislative review. The methods used to determine the employer rates for all Retirement Systems are specified in Kentucky Revised Statute 61.565. Employee contribution rates are set by statute and may be changed only by the Kentucky General Assembly.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE A-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Recent Accounting Pronouncement

In June 2008, the Governmental Accounting Standards Board (GASB) issued Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments", effective for financial statements issued for periods beginning after June 15, 2009. The objective of this statement is to enhance the usefulness and comparability of derivative instrument information reported by state and local governments. It also provides a comprehensive framework for the measurement, recognition, and disclosure of derivative instrument transactions. KRS is currently evaluating the provisions of GASB No. 53.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

Membership of each Retirement Plan consisted of the following at June 30, 2009 and 2008:

KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	2009			2008		
	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
<u>Number of Members</u>						
Retirees and beneficiaries receiving benefits	37,863	2,648	40,531	35,307	2,404	37,711
Inactive vested memberships	34,515	3,056	37,571	33,202	2,927	36,129
Active plan members	<u>46,060</u>	<u>4,334</u>	<u>50,394</u>	<u>48,085</u>	<u>4,393</u>	<u>52,478</u>
Total	<u>118,458</u>	<u>10,038</u>	<u>128,496</u>	<u>116,594</u>	<u>9,724</u>	<u>126,318</u>
Number of participating employers			<u>386</u>			<u>317</u>

COUNTY EMPLOYEES RETIREMENT SYSTEM

	2009			2008		
	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
<u>Number of Members</u>						
Retirees and beneficiaries receiving benefits	39,756	5,808	45,564	37,579	5,422	43,001
Inactive vested memberships	60,275	2,522	62,797	57,755	2,376	60,131
Active plan members	<u>83,724</u>	<u>9,757</u>	<u>93,481</u>	<u>85,221</u>	<u>10,173</u>	<u>95,394</u>
Total	<u>183,755</u>	<u>18,087</u>	<u>201,842</u>	<u>180,555</u>	<u>17,971</u>	<u>198,526</u>
Number of participating employers			<u>1,398</u>			<u>1,468</u>

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

STATE POLICE RETIREMENT SYSTEM

	2009	2008
<u>Number of Members</u>	<u>Hazardous Position Employees</u>	<u>Hazardous Position Employees</u>
Retirees and beneficiaries receiving benefits	1,184	1,135
Inactive vested memberships	332	301
Active plan members	946	993
Total	2,462	2,429
Number of participating employers	1	1

KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND

Hospital and Medical Contracts in force consisted of the following at June 30, 2009 and 2008:

	2009					2008				
	<u>Single</u>	<u>Couple/ Family</u>	<u>Parent</u>	<u>Medicare Without Prescription</u>	<u>Medicare With Prescription</u>	<u>Single</u>	<u>Couple/ Family</u>	<u>Parent</u>	<u>Medicare Without Prescription</u>	<u>Medicare With Prescription</u>
KERS Non-Hazardous	10,536	2,417	739	1,904	13,189	9,631	2,099	584	1,960	12,653
KERS Hazardous	866	690	95	93	832	795	618	93	96	749
CERS Non-Hazardous	7,503	1,364	326	3,099	13,607	7,306	1,278	291	3,112	12,829
CERS Hazardous	1,438	2,108	254	82	1,558	1,411	2,017	232	77	1,396
SPRS	221	311	20	9	419	241	302	17	7	407
Totals	20,564	6,890	1,434	5,187	29,605	19,384	6,314	1,217	5,252	28,034

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

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 KERS. 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 adjustments (COLA) 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 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky 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 fiscal years ended June 30, 2009 and 2008, plan members were required to contribute 5% of their annual creditable compensation. The Commonwealth 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 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 fiscal years ended June 30, 2009 and 2008, participating employers contributed 10.01% and 8.5%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2009 and 2008 were 28.6% and 48.37%, respectively, of each employee's creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 6% of their annual creditable compensation. Five percent of the contribution was deposited to the member's account while the 1% was deposited to an account created under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 5% of their annual creditable compensation.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

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 KERS. 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 adjustments (COLA) 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 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky 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 fiscal years ended June 30, 2009 and 2008, plan members were required to contribute 8% of their annual creditable compensation. The Commonwealth 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 fiscal years ended June 30, 2009 and 2008, participating employers contributed 24.35% and 24.25%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2009 and 2008 were 34.78% and 47.11%, respectively, of each employee's creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 9% of their annual creditable compensation. Eight percent of the contribution was deposited to the member's account while the 1% was deposited to an account created under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 8% of their annual creditable compensation.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

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 participating county, city, and school board, and any additional eligible local agencies electing to participate in CERS. 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 adjustments (COLA) 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 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky 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 fiscal years ended June 30, 2009 and 2008, 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 fiscal years ended June 30, 2009 and 2008, participating employers contributed 13.5% and 16.17%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2009 and 2008 were 15.58% and 16.17%, respectively. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 6% of their annual creditable compensation. Five percent of the contribution was deposited to the member's account while the 1% was deposited to an account created under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 5% of their annual creditable compensation.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

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 CERS. 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 adjustments (COLA) 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 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky 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 fiscal years ended June 30, 2009 and 2008, 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 fiscal years ended June 30, 2009 and 2008, participating employers contributed 29.5% and 33.87%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2009 and 2008 were 31.99% and 33.87%, respectively, of each employee's creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 9% of their annual creditable compensation. Eight percent of the contribution was deposited to the member's account while the 1% was deposited to an account created under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 8% of their annual creditable compensation.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

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 adjustments (COLA) 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 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The Kentucky 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 fiscal years ended June 30, 2009 and 2008 plan members were required to contribute 8% of their annual creditable compensation. The Commonwealth 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 fiscal years ended June 30, 2009 and 2008, the Commonwealth contributed 30.07% and 28%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2009 and 2008 were 60.14% and 120%, respectively, of each employee's creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 9% of their annual creditable compensation. Eight percent of the contribution was deposited to the member's account while the 1% was deposited to an account created under 26 USC Section 401(h) in the Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Interest is paid each June 30 on members' accounts at a rate of 2.5%. If a member terminates employment and applies to take a refund, the member is entitled to a full refund of contributions and interest; however, the 1% contribution to the 401(h) account is non-refundable and is forfeited. For plan members who began participating prior to September 1, 2008, their contributions remain at 8% of their annual creditable compensation.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

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 KERS, CERS, and SPRS. The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. For the fiscal year ended June 30, 2009, insurance premiums withheld from benefit payments for members of the systems were \$28,345,215 and \$973,502 for KERS non-hazardous and hazardous, respectively; \$27,593,841 and \$1,634,508 for CERS non-hazardous and hazardous, respectively; and, \$160,190 for SPRS. For fiscal 2008, insurance premiums withheld from benefit payments for members of KERS were \$25,897,389 and \$861,730 for KERS non-hazardous and KERS hazardous, respectively; \$25,809,726 and \$1,571,639 for CERS non-hazardous and CERS hazardous, respectively; and, \$167,965 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, 2009, the Fund had 87,279 retirees and beneficiaries for whom benefits were available.

The amount of contribution paid by the Funds is based on years of service. For members participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

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

As a result of House Bill 290 (2004 Kentucky General Assembly), medical insurance benefits are calculated differently for members who began participating on, or after, July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on, or after, July 1, 2003 earn ten dollars (\$10) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Hazardous employees whose participation began on, or after, July 1, 2003 earn fifteen dollars (\$15) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Upon death of a hazardous employee, the employee's spouse receives ten dollars (\$10) per month for insurance benefits for each year of the deceased employee's earned hazardous service. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment (COLA), which is updated annually due to changes in the Consumer Price Index for all urban consumers. This benefit is not protected under the inviolable contract provisions of Kentucky Revised Statute 16.652, 61.692 and 78.852. The Kentucky General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND, CONTINUED

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.

KRS commenced self-funding of healthcare benefits for its Medicare eligible retirees on January 1, 2006. A self-funded plan is one in which KRS assumes the financial risk for providing healthcare benefits to its retirees. The self-funded plan pays for claims out-of-pocket as they are presented instead of paying a pre-determined premium to an insurance carrier for a fully-insured plan. KRS funds the risk directly from its assets. KRS becomes directly responsible for administering benefits under the plan.

KRS' plan is defined by statute. KRS selected Walgreens Health Initiatives and UMR to administer the pharmaceutical and medical benefits, respectively, for its retirees.

Stop-loss insurance can be arranged to limit KRS' loss to a specified amount to ensure that catastrophic claims do not upset the financial integrity of the self-funded plan. The amount of stop-loss insurance is a function of KRS' size, nature of its business, financials, and tolerance for risk. KRS continues to evaluate the use of stop-loss insurance.

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

The provisions of Governmental Accounting Standards Board (GASB) 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 GASB No. 28, KRS 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 RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE C-CASH AND SHORT-TERM INVESTMENTS AND SECURITIES LENDING COLLATERAL, CONTINUED

KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	2009	2008
Cash	\$ 369,675	\$ 321,001
Short-Term Investments	286,363,442	83,942,355
Securities Lending Collateral Invested	740,443,331	1,256,541,062
Total	\$ 1,027,176,448	\$ 1,340,804,418

COUNTY EMPLOYEES RETIREMENT SYSTEM

	2009	2008
Cash	\$ 379,842	\$ 561,437
Short-Term Investments	698,898,569	114,249,050
Securities Lending Collateral Invested	1,049,855,428	1,601,257,307
Total	\$ 1,749,133,839	\$ 1,716,067,794

STATE POLICE RETIREMENT SYSTEM

	2009	2008
Cash	\$ 102,694	\$ 86,526
Short-Term Investments	32,170,928	1,601,088
Securities Lending Collateral Invested	47,878,450	76,543,782
Total	\$ 80,152,072	\$ 78,231,396

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE C-CASH AND SHORT-TERM INVESTMENTS AND SECURITIES LENDING COLLATERAL, CONTINUED

KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND

	<u>2009</u>	<u>2008</u>
Cash	\$ 179,764	\$ 220,702
Short-Term Investments	495,121,909	306,845,068
Medicare Drug Deposit	100,000	
Securities Lending Collateral Invested	<u>428,831,036</u>	<u>773,837,984</u>
Total	<u>\$ 924,232,709</u>	<u>\$ 1,080,903,754</u>

NOTE D-INVESTMENTS

The Board of Trustees of KRS recognizes its duty to invest funds in accordance with the "Prudent Person Rule" and manage those funds consistent with the long-term nature of KRS. 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 US Government or any agency or instrumentality of the US 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 US Government or the Commonwealth of Kentucky.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

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 Short Term Investment Funds (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 an investment grade 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 - Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indices. 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 Pension and Insurance Funds invest in collateralized mortgage obligations (CMOs) and other asset-backed securities to increase return and adjust duration of the portfolio. The Pension and Insurance Funds 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.

Collateralized mortgage obligations, asset-backed securities, and exchange-traded funds pose no greater risk than other similar investment grade holdings in KRS' and the Fund's portfolios. The fair value of CMOs at June 30, 2009 and 2008, was approximately \$266 million and \$282 million, respectively; the fair value of asset-backed securities at June 30, 2009 and 2008, was approximately \$102 million and \$219 million, respectively; and, the fair value of exchange-traded funds at June 30, 2009 and 2008, was approximately \$196 million and \$451 million, respectively.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Custodial Credit Risk for Deposits - Custodial credit risk for deposits is the risk that in the event of a financial institution failure, KRS' deposits may not be returned. All non-investment related bank balances are held locally by Farmer's Bank & Capital Trust Company. All non-investment related bank balances are held in KRS' name and each individual account is insured by the Federal Deposit Insurance Corporation (FDIC). Effective October 3, 2008, FDIC deposit insurance temporarily increased from \$100,000 to \$250,000 for each individual account through December 31, 2009. On May 20, 2009, the temporary increase in FDIC deposit insurance coverage from \$100,000 to \$250,000 for each depositor was extended through December 31, 2013. These cash balances are invested daily by the local institution in overnight repurchase agreements which are required by Kentucky Administrative Regulations (200 KAR 14:081) to be collateralized at 102% of the principal amount.

At June 30, 2009 and 2008, deposits for KRS pension funds were \$3,568,343 and \$7,685,550, respectively. None of these balances were exposed to custodial credit risk as they were either insured or collateralized at required levels.

At June 30, 2009 and 2008, deposits for KRS insurance fund were \$289,006 and \$204,343, respectively. None of these balances were exposed to custodial credit risk as they were either insured or collateralized at required levels.

Custodial Credit Risk for Investments - Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to a transaction, KRS will not be able to recover the value of investments or collateral securities that are in the possession of an outside third party. KRS does not have an explicit policy with regards to Custodial Credit Risk for investments. At June 30, 2009 and 2008, the following investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in KRS' name.

	<u>2009</u>	<u>2008</u>
Pension Funds		
Foreign Currency Investments	\$5,064,552	\$ 3,486,140
Insurance Fund		
Foreign Currency Investments	\$2,550,222	\$ 1,103,211

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Investment Policies - Kentucky Revised Statute 61.650 grants the responsibility for the investment of plan assets to the Board of Trustees of KRS. The Board of Trustees has established an Investment Committee which is specifically charged with the oversight and investment of plan assets. The Investment Committee recognizes their duty to invest the funds in accordance with the "Prudent Person Rule" (set forth in Kentucky Revised Statute 61.650) and manage those funds consistent with the long-term nature of the Systems. The Committee has adopted a *Statement of Investment Policy* that contains guidelines and restrictions for deposits and investments. By statute, all investments are to be registered and held in the name of KRS. The *Statement of Investment Policy – Pension* contains the specific guidelines for the investment of pension assets. The *Statement of Investment Policy – Insurance* contains the specific guidelines for the investment of insurance assets. Additionally, the Committee establishes specific investment guidelines in the Investment Management Agreement for each investment management firm.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Investment Summary

The following tables present a summary of the investments by type as of June 30, 2009 and 2008:

Pension Funds As of June 30, 2009 and 2008

Investment Summary

	2009	2008
US Gov't & Agency Fixed Income Securities	\$ 2,301,499,200	\$ 3,167,327,985
US Corporate Fixed Income Securities	906,485,006	1,457,701,305
Municipal Debt Securities	20,093,413	3,189,898
Short-term Investments	1,017,432,938	199,792,495
Equity Securities	4,567,119,849	7,093,291,910
Private Equity Limited Partnerships	978,848,929	902,624,336
Real Estate	14,945,575	9,545,575
Impairment-Securities Lending*	(39,279,421)	
	\$ 9,767,145,489	\$ 12,833,473,504

Insurance Funds As of June 30, 2009 and 2008

Investment Summary

	2009	2008
US Gov't & Agency Fixed Income Securities	\$ 203,303,796	\$ 330,535,852
Short-term Investments	495,221,921	306,845,080
Equity Securities	1,222,700,032	1,868,037,394
Private Equity Limited Partnerships	109,261,059	100,291,617
Alternative Investment	135,000	135,000
Real Estate	600,000	
Impairment-Securities Lending*	(8,984,210)	
	\$ 2,022,237,598	\$ 2,605,844,943

*See note E for detailed information

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Credit Risk of Debt Securities - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The debt security portfolios are managed by the Investment Division staff and by external professional investment management firms. All portfolio managers are required by the *Statement of Investment Policy* to maintain diversified portfolios. Each portfolio is also required to be in compliance with risk management guidelines that are assigned to them based upon the portfolio's specific mandate. In total, the pension fund debt securities portfolio is managed using the following guidelines adopted by the KRS Board of Trustees:

- Bonds, notes or other obligations issued or guaranteed by the US Government, its agencies or instrumentalities are permissible investments and may be held without restrictions.
- The duration of the total fixed income portfolio shall not deviate from the blended Barclays Capital Aggregate Index/KRS High Yield Index by more than 10%.
- The duration of the TIPS portfolio shall not deviate from the Barclays Capital TIPS Index by more than 10%.
- The amount invested in the debt of a single corporation shall not exceed 5% of the total market value of KRS' assets.
- No public fixed income manager shall invest more than 5% of the market value of assets held in any single issue short term instrument, with the exception of US Government issued, guaranteed or agency obligations.
- The amount invested in SEC Rule 144a securities shall not exceed 7.5% of the market value of the aggregate market value of KRS' fixed income investments.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

The following tables present the KRS pension fund debt ratings at June 30, 2009 and 2008:

Pension Funds		
Debt Securities Investments at Fair Value		
As of June 30, 2009 and 2008		
Quality Rating	2009	2008
AAA	\$ 443,511,715	\$ 1,852,092,028
AA+	16,824,633	3,146,943
AA	29,223,881	55,711,654
AA-	14,112,366	69,155,369
A+	64,261,249	64,663,074
A	156,858,363	94,408,564
A-	60,256,001	74,151,200
BBB+	81,424,712	107,130,804
BBB	107,077,314	106,177,690
BBB-	62,510,693	74,797,060
BB+	6,241,124	2,156,766
BB	13,693,541	8,702,285
BB-	2,212,888	
B+	3,389,891	
B	4,189,229	
B-	923,953	3,403,560
CCC	7,319,295	
CC	278,130	
NR	46,927,613	166,287,656
Total Credit Risk Debt Securities	1,121,236,591	2,681,984,653
Government Bonds	394,575,945	267,456,013
Government Mortgage-Backed Securities (GNMA)	736,182,469	48,454,865
Indexed Linked Bonds	976,082,613	1,630,323,657
Total Debt Securities	\$ 3,228,077,618	\$ 4,628,219,188

At both June 30, 2009 and 2008, the weighted average quality rating of the pension fund debt securities portfolio was AA+. As of June 30, 2009 and 2008, the KRS pension portfolio had \$38,248,051 and \$14,262,611, respectively, in debt securities rated below BBB-. The fair value of securities in the BBB- rating category was \$62,510,693 and \$74,797,060, respectively, as of June 30, 2009 and 2008.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

The insurance fund debt securities portfolio, by guidelines, is to be invested in US Government securities. As shown below, as of June 30, 2009 and 2008, the entire insurance fund was invested in Treasury Inflation Protected Securities (TIPS) which carry a US Government treasury rating.

Insurance Fund		
Credit Risk of Debt Securities		
As of June 30, 2009 and 2008		
	2009	2008
Treasury Inflation Protected Securities	\$ 203,303,796	\$ 330,535,852

Concentration of Credit Risk Debt Securities - Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's exposure in a single issuer.

The total debt securities portfolio is managed using the following general guidelines adopted by the KRS Board of Trustees:

- Bonds, notes or other obligations issued or guaranteed by the US Government, its agencies or instrumentalities are permissible investments and may be held without restrictions.
- Debt obligations of any single US Corporation shall be limited to a maximum of 5 percent of the total portfolio at market value.

As of June 30, 2009, the Insurance Fund held 6% of its investments in Exchange Traded Funds (ETF's). The amount totaled \$131,013,116 as of June 30, 2009. ETF's are securities that represent ownership in a long term unit investment trust that holds a portfolio of common stocks designed to track the performance of a designated index. Similar to a stock, ETF's can be traded continuously throughout the trading day, or can be held for the long term.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

As of June 30, 2009, the Pension Fund held 5.18% of its investment in the Federal National Mortgage Association (Fannie Mae). The amount totaled \$508,465,653 as of June 30, 2009. Historically, Fannie Mae has been a publicly owned government corporation, recently entering conservatorship by the US Government, to purchase mortgages from lenders and resell them to investors; shares of Fannie Mae are traded on the New York Stock Exchange. Fannie Mae's debt has been perceived to be nearly as safe as US Treasury debt, given the US Government's implicit guarantee which has allowed it to pay lower interest rates to its debt holders.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The risk is managed by using the effective duration or option adjusted methodology. It is widely used in the management of fixed income portfolios by quantifying the risk of inherent rate changes. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. The effective duration measures the sensitivity of the market price to changes in the yield curve. Effective duration is the most accurate duration measure when a significant portion of the securities are callable (redeemable) prior to maturity. The pension fund portfolio contains a number of securities that are callable and therefore interest rate risk is most appropriately measured by effective duration. KRS does not have a formal policy that constrains the duration of its fixed income portfolio.

The KRS pension fund debt securities portfolio benchmarks its debt securities portfolio to a weighted average benchmark consisting of the Barclays Capital Aggregate Index and the Barclays Capital US TIPS Index. At June 30, 2009 and 2008, the effective duration of the benchmark was 4.196 and 5.34, respectively. At the same points in time, the effective duration of the KRS pension fund debt securities portfolio was 4.45 and 5.25, respectively.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

KRS Pension Funds Interest Rate Risk

	2009	Weighted Average Effective Duration	2008	Weighted Average Effective Duration
Asset Backed Securities	\$ 101,699,907	0.36	\$ 219,570,012	0.65
Commercial Mortgage Backed Securities	106,131,129	4.40	284,582,636	4.69
Corporate Bonds	538,973,533	6.01	676,082,460	6.36
Government Agencies	131,949,021	3.70	156,429,791	3.75
Government Bonds	1,370,658,558	5.22	1,938,543,143	6.84
Government Mortgage Backed Securities	736,182,469	3.36	1,063,447,866	3.92
Municipal Bonds	20,093,413	7.48	3,189,898	8.20
Non-Government Backed Collateralized Mortgage Obligations	162,234,869	1.38	280,513,429	1.66
Other Fixed Income	60,154,719	2.45	5,859,953	
Total	\$ 3,228,077,618	4.45	\$ 4,628,219,188	5.25

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

The KRS insurance fund long-term debt securities portfolio consists entirely of US Government issued bonds which are not callable (redeemable) prior to maturity. The modified duration, similar to effective duration, measures the sensitivity of the market prices to changes in the yield curve but does not assume that securities will be called prior to maturity. Since the modified duration measure most accurately reflects the interest rate sensitivity of the insurance fund portfolio, this measure is used for comparative purposes. The KRS insurance fund debt securities portfolio benchmarks its debt securities portfolio to the Barclays Capital US TIPS Index. At June 30, 2009 and 2008, the modified duration of the benchmark was 4.21 and 7.00, respectively. At the same points in time, the modified duration of the KRS insurance fund debt securities portfolio, excluding the pooled fund, was 7.46 and 7.8, respectively.

Insurance Fund Debt Securities Investments at Fair Value As of June 30, 2009 and 2008				
	2009		2008	
<u>Investment</u>	<u>Fair Value</u>	<u>Weighted Duration</u>	<u>Fair Value</u>	<u>Weighted Duration</u>
Index Linked Government Bonds	\$203,303,796	7.46	\$330,535,852	7.80

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Foreign Currency Risk - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. KRS' currency risk exposure, or exchange rate risk, primarily resides within KRS' international equity holdings. KRS does not have a formal policy to limit foreign currency risk. The following tables present KRS' exposure to foreign currency risk at June 30, 2009 and 2008:

	Pension Funds	
	Investments at Fair Value	
	June 30, 2009 and 2008	
	2009	2008
Foreign Equities		
Australian Dollar	\$ 52,486,171	\$ 108,703,282
British Pound Sterling	224,888,843	347,502,090
Canadian Dollar	50,996,657	
Danish Krone	2,837,998	10,215,805
Euro	321,770,916	602,712,262
Hong Kong Dollar	30,196,000	42,788,359
Japanese Yen	247,828,407	360,039,117
Malaysian Ringgit	5,471,194	4,822,484
New Taiwan Dollar	3,081,020	
Norwegian Krone	6,671,898	8,462,661
Singapore Dollar	22,514,427	33,380,301
South African Rand	3,065,838	2,724,924
South Korean Won	7,575,310	8,878,461
Swedish Krona	12,083,380	22,736,416
Swiss Franc	87,953,959	132,737,018
International Equity Mutual Fund (various currencies)	484,383,452	3,375,984
Total Securities subject to Foreign Currency Risk	1,563,805,470	1,689,079,164
USD (securities held by International Investment Managers)	507,357,622	899,009,887
Total International Investment Securities	\$ 2,071,163,092	\$ 2,588,089,051

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Insurance Fund
Investments at Fair Value
June 30, 2009 and 2008

	2009	2008
Foreign Equities		
Australian Dollar	\$ 21,131,446	\$ 35,134,773
Brazilian Real	360,704	
British Pound Sterling	83,508,340	109,029,509
Canadian Dollar	28,155,840	
Danish Krone	1,352,355	3,306,933
Euro	123,126,478	189,066,281
Hong Kong Dollar	13,879,837	13,504,229
Japanese Yen	92,771,022	112,165,271
Malaysian Ringgit	1,576,196	1,373,536
Mexican Peso	58,868	
New Taiwan Dollar	1,846,498	1,278,371
Norwegian Krone	3,071,113	2,758,439
Singapore Dollar	7,427,113	10,752,813
South African Rand	1,104,155	825,396
South Korean Won	3,859,160	2,678,342
Swedish Krona	4,425,313	7,113,693
Swiss Franc	32,594,627	41,108,670
International Equity Mutual Fund (various currencies)	80,975,131	102,752,830
Total Securities subject to Foreign Currency Risk USD (securities held by International Investment Managers)	501,224,196	632,849,086
Total International Investment Securities	\$ 521,802,518	\$ 691,300,242

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

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. The types of securities lent include US Treasuries, US Agencies, US Corporate Bonds, US Equities, Global Fixed Income Securities, and Global Equities Securities. The *Statement of Investment Policy-Pension* and the *Statement of Investment Policy-Insurance* do not address any restrictions on the amount of loans that can be made. At June 30, 2009, KRS had no credit risk exposure to borrowers because the collateral amounts received exceeded the amounts out on loan. The contracts with the custodial banks require them to indemnify KRS 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 KRS. 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.

In September 2008, the ongoing financial market crisis took an adverse turn. Securities issued by many financial institutions and other entities experienced significant financial distress as a result of the financial market turmoil. Several government sponsored entities were put under the conservatorship of the US Government, and other foreign and domestic financial institutions received capital infusions or other types of capital support from their respective governments' central banks. The US Federal Reserve and US Treasury initiated various actions to enhance liquidity to stabilize the financial markets.

Following the cumulative effect of these factors, Northern Trust (the custodial bank for KRS) determined that certain securities held within the collateral pools had experienced impairment in value. Accordingly, Northern Trust determined in September 2008 a "Collateral Deficiency" assessment (in broad terms, the shortfall between the market NAV and the \$1 NAV) in its collateral pools under the terms of its Securities Lending Authorization Agreement.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE E-SECURITIES LENDING TRANSACTIONS, CONTINUED

Per the Agreement, each participant (including KRS) in the collateral pool was allocated their share of the Collateral Deficiency which comprised both unrealized (primarily) and realized losses. Northern Trust elected to book this obligation as a receivable to each collateral pool, avoiding any immediate cash outflows by participants. Northern Trust determined that the receivable could be removed or reduced through a variety of mechanisms such as potential future "reversal" of the unrealized Collateral Deficiency loss. In addition, the affected collateral pools were closed to new investors (ensuring that any "reversal" would not be shared with new investors which is disadvantageous to KRS). The ultimate value of these impaired assets will be driven by a variety of factors including market and regulatory forces, as well as the outcome of bankruptcy proceedings.

Subsequent to the Collateral Deficiency, Northern Trust made a direct cash contribution of approximately \$5.7 million to KRS whose cash collateral was invested in the Core and Global Collateral Pools. Northern Trust also reduced its portion of the fee split relating to revenues generated in the affected collateral pools by 20% (effective October 1, 2008 and continuing for the next 12 months).

KRS maintains a conservative approach to investing the cash collateral with Northern Trust for its securities lending collateral pools, emphasizing capital preservation, liquidity, and credit quality.

As of June 30, 2009, the impairment in the pension funds totaled \$39,279,421 and the impairment in the insurance fund totaled \$8,984,210, for a total impairment of \$48,263,631. This is an unrealized loss and may decrease with time if the market values of assets increase.

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 KRS, or any of its staff as a result of an 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 \$100,000. 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.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE F-RISKS OF LOSS, CONTINUED

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.

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 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.

NOTE I-DEFINED BENEFIT PENSION PLAN

All eligible employees of KRS participate in KERS (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. Plan members contributed 5% of creditable compensation for the periods ended June 30, 2009, 2008, and 2007. The Commonwealth contributed 10.01%, 8.5%, and 7.75% of covered payroll for the periods ended June 30, 2009, 2008, and 2007, respectively. The chart below includes the covered payroll and contribution amounts for KRS for the three periods included in this discussion.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Covered Payroll	\$ 12,864,700	\$ 11,846,700	\$ 11,269,800
Employer Contributions	1,287,800	1,007,000	873,400

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE J-EQUIPMENT

Equipment consists of the following:

	June 30	
	2009	2008
Equipment, at cost	\$ 8,870,569	\$ 9,151,744
Less Accumulated Depreciation	<u>(2,715,603)</u>	<u>(2,753,294)</u>
	<u>\$ 6,154,966</u>	<u>\$ 6,398,450</u>

Depreciation expense for the fiscal years ended June 30, 2009 and 2008 amounted to \$299,578 and \$378,887, respectively.

As of June 30, 2009, KRS had approximately \$4.8 million in assets yet to be depreciated in relation to the START project. See note K for further information regarding the START project.

NOTE K—INTANGIBLE ASSETS

The provisions of Governmental Accounting Standards Board (GASB) Statement No. 51, "Accounting and Financial Reporting for Intangible Assets" require that intangible assets be recognized in the Statement of Plan Net Assets only if they are considered identifiable. In conjunction with the adoption of GASB No. 51, KRS has capitalized software costs as indicated below for the Strategic Technology Advancements for the Retirement of Tomorrow (START) project.

Software consists of the following:

	June 30	
	2009	2008
Software, at cost	\$ 2,259,480	\$ 2,259,480
Less Accumulated Amortization	<u>(345,931)</u>	<u>(119,983)</u>
	<u>\$ 1,913,549</u>	<u>\$ 2,139,497</u>

Amortization expense for the fiscal years ended June 30, 2009 and 2008 amounted to \$225,948 and \$119,983, respectively.

In fiscal 2007, KRS initiated the START project. It is anticipated that START will be completed in its entirety in fiscal 2011. The objectives of the project are to provide employees with a technology solution that will enable them to serve more customers more quickly while providing continued superior service; to enhance business services and improve operational efficiency; to improve the accuracy of the information collected, maintained, and provided; to improve the timeliness and accuracy of responses to members' inquiries; to provide internet based, self-service capabilities to members, retirees, and employers; and, to ensure that retirees receive monthly benefits without error or disruption.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE L-ALTERNATIVE INVESTMENTS

On February 6, 2006, the health insurance fund of KRS loaned to KRS Perimeter Park West, Inc., a related party, \$700,000 for the purchase of real property at 1300 Louisville Road, Frankfort, Kentucky. The loan was not documented by a note, mortgage contract, or security interest in the property. The transfer of funds involved a commingling with the pension fund which was in violation of Internal Revenue Code Sections 401 and 420. However, KRS voluntarily self-corrected the violation in accordance with Revenue Procedure 2006-27 of the Internal Revenue Bulletin 2006-22, page 945, "Employee Plans Compliance Resolution System (EPCRS)", and Section 1101 of the Pension Protection Act of 2006. The self-correction process involved a Letter of Direction sent to Northern Trust (the custodial bank of KRS) to reverse (and to correct the commingling of funds) the loan in the investment accounts.

Subsequent to the loan and purchase, the real property was valued by appraisal from \$135,000 to \$290,000. The range of appraisal values was based upon considerations of zoning classifications, site preparations and improvements, and other matters. KRS decided to reflect the alternative investment at the lowest appraisal value for the property in accordance with Governmental Accounting Standards Board (GASB) Statement No. 43 "Financial Reporting for Postemployment Benefit Plans other than Pension Plans", paragraphs 22 and 92, and in accordance with the Principle of Conservatism of Generally Accepted Accounting Principles. Because of the significant difference in the appraised value of the property and the loan amount, and also because the loan was not documented by a note, mortgage contract, or security interest in the property, KRS was uncertain whether it would collect any principal (or interest) in excess of the minimum appraised property value. Therefore, as of June 30, 2006, KRS management elected to write-down the value of the Alternative Investment to an estimated collectible value of \$135,000, which has been the investment's carrying value since the date of the loan. As a result, the unrealized loss amounted to \$565,000 (\$700,000 - \$135,000), which was included in the Combined Statement of Changes in Plan Net Assets – Insurance Fund for the 2006 fiscal year.

On June 11, 2009, the property at 1300 Louisville Road, along with Building B (a part of the Perimeter Park Complex purchased in 1998) was sold for a combined sale price of \$3,200,000 to the Commonwealth of Kentucky. The two properties were appraised individually on December 15, 2008, by the Forrestal Group, Inc., of Evansville, Indiana. The property at 1300 Louisville Road appraised for \$295,000, and Building B appraised for \$2,725,000.

On September 15, 2009, the management of KRS Perimeter Park West, Inc. repaid \$700,000 out of the proceeds from the sale of these two properties to the health insurance fund of KRS to repay the aforementioned loan. In addition to the repayment of the principal, interest in the amount of \$127,298 was paid. The simple interest was computed at 5.04% and the period of 1,317 days outstanding (February 6, 2006, to September 15, 2009) was used for the calculation. Interest in the amount of \$119,855 has been accrued as a receivable as June 30, 2009. In addition, KRS reimbursed KRS Perimeter Park West, Inc. for expenses it incurred as part of the purchase of the real property at 1300 Louisville Road; the amount reimbursed totaled \$52,502.

The Kentucky Finance and Administration Cabinet, Office of Policy and Audit, completed a comprehensive audit of the 1300 Louisville Road property purchased and issued a report in July 2009. KRS has fully implemented the four recommendation contained in the report.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE M—ACTUARIAL VALUATION

The provisions of Governmental Accounting Standards Board (GASB) Statement No. 50, "Pension Disclosures, an Amendment of GASB No. 25 and No. 27", require that actuarial information included in the Notes to the Required Supplementary Information be moved to the Notes to the Financial Statements. In conjunction with the adoption of GASB No. 50, KRS has moved the following information from the Notes to the Required Supplementary Information to the Notes to the Financial Statements:

	PENSION FUNDS	
	Non-Hazardous	Hazardous
Valuation Date	June 30, 2009	June 30, 2009
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	28 Years	28 Years
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market
Actuarial Assumptions:		
Investment Return*	7.75%	7.75%
*Includes Inflation Rate at	4.5%	4.5%
Projected Salary Increases	4.75%-17.0%	4.5%-21.0%
Cost of Living Adjustment	None	None

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE M—ACTUARIAL VALUATION, CONTINUED

INSURANCE FUND

	<u>Non-Hazardous</u>	<u>Hazardous</u>
Valuation Date	June 30, 2009	June 30, 2009
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	28 Years	28 Years
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market
Medical Trend Assumption	10.5-5.00%	10.5-5.00%
Year of Ultimate Trend	2017	2017
Actuarial Assumptions:		
Investment Return*	7.75%**	7.75%
*Includes Inflation Rate at	4.5%	4.5%

**The actuarial investment rate of return for developing insurance liabilities and contribution rates is 4.5% for the Kentucky Employees Retirement System (non-hazardous) and the State Police Retirement System. The lower rate is required under the parameters set by the Governmental Accounting Standards Board (GASB) Statements 43 and 45 given the lack of pre-funding of insurance benefits.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE M—ACTUARIAL VALUATION, CONTINUED

KRS had the following Unfunded Actuarial Accrued Liabilities as of June 30 2009 and 2008:

Pension Funds:	<u>2009</u>	<u>2008</u>
Kentucky Employees Retirement System (Non-Hazardous)	\$5,863,938,167	\$4,810,897,092
Kentucky Employees Retirement System (Hazardous)	171,908,494	115,878,613
County Employees Retirement System (Non-Hazardous)	2,262,123,521	1,572,715,253
County Employees Retirement System (Hazardous)	826,957,060	652,254,722
State Police Retirement System	<u>272,361,879</u>	<u>236,237,806</u>
Total Pension Funds	<u>9,397,289,121</u>	<u>7,387,983,486</u>
Insurance Fund:		
Kentucky Employees Retirement System (Non-Hazardous)	3,973,152,991	4,828,301,524
Kentucky Employees Retirement System (Hazardous)	189,497,578	253,495,455
County Employees Retirement System (Non-Hazardous)	1,853,754,249	2,414,310,296
County Employees Retirement System (Hazardous)	942,417,481	1,156,256,638
State Police Retirement System	<u>240,504,494</u>	<u>321,146,271</u>
Total Insurance Fund	<u>7,199,326,793</u>	<u>8,973,510,184</u>
Total Unfunded Actuarial Accrued Liability	<u>\$16,596,615,914</u>	<u>\$16,361,493,670</u>

The Schedule of Funding Progress for the Pension Funds is on pages 53 through 55. The Schedule of Funding Progress for the Insurance Fund is on pages 56 through 58.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE N—HOUSE BILL 1 PENSION REFORM

House Bill 1 was signed by the Governor of the Commonwealth on June 27, 2008. It contained a number of changes that KRS implemented effective September 1, 2008. House Bill 1 also contained statutory changes to Kentucky Revised Statute 61.637, the law governing members who become reemployed following retirement.

Employee contributions for non-hazardous employees who began participating with KRS on, or after, September 1, 2008, contributed a total of 6% of all their creditable compensation to KRS. Five percent of this contribution was deposited to the individual employee's account, while the other 1% was deposited to an account created under 26 USC Section 401(h) in the KRS Pension Fund (see Kentucky Administrative Regulation 105 KAR 1:420E). Hazardous employees who began participating with KRS on, or after, September 1, 2008, contributed a total of 9% of all their creditable compensation, with 8% credited to the member's account, and 1% deposited to the KRS Pension Fund 401(h) account. Interest paid each June on these members' accounts is set at a rate of 2.5%. If a member terminates his/her employment and applies to take a refund, the member is entitled to a full refund of contributions and interest in his/her account; however, the 1% contributed to the 401(h) account in the KRS Pension Fund is non-refundable and is forfeited.

Employer contribution rates for KERS and SPRS for fiscal 2009 were established in the 2008-2010 Executive Branch Budget (House Bill 460) during the 2008 session of the Kentucky General Assembly. Employer contribution rates for CERS for fiscal 2009 were enacted by House Bill 1 in the 2008 Special Legislative Session. The Employer contribution rates were established as follows (effective July 1, 2008):

KERS-Non Hazardous	10.01%
KERS-Hazardous	24.35%
CERS-Non Hazardous	13.50%
CERS-Hazardous	29.50%
SPRS	30.07%

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE N—HOUSE BILL 1 PENSION REFORM, CONTINUED

Although the majority of changes in this legislation only impacted new hires on, or after, September 1, 2008, there were some changes that affected all members and retirees of KRS:

Cost of Living Adjustment (COLA): Beginning July 1, 2009, COLA for retirees will now be set at 1.5% each July 1. The Kentucky General Assembly may increase this percentage at any time, but only if appropriate funding is allocated. The General Assembly may also reduce or suspend the annual COLA.

Service Purchase Costs: The actuarial factors used to determine the cost to purchase a service will now assume the earliest date a member can retire with an unreduced benefit, and will also include a COLA. This change will result in an increased service purchase cost for any purchase calculated on, or after, September 1, 2008. This change will also affect the cost billed to employers for sick leave when an employee retires.

Payment Options: The Partial Lump Sum Payment Options was only available for those employees who retired on, or before, January 1, 2009.

Kentucky Revised Statute 61.637 was modified significantly by House Bill 1. Specifically, a retiree reemployed on, or after, September 1, 2008, cannot accrue additional service credit in KRS, even if employed in a position that would otherwise be required to participate in KRS. However, if a retiree is reemployed in a regular full time position, his/her employer is required to pay contributions on all creditable compensation earned during the period of reemployment. These contributions are used to reduce the unfunded actuarial liability.

NOTE O – MEDICARE PRESCRIPTION DRUG PLAN

In fiscal 2009, Kentucky Retirement Systems submitted an application to the Centers for Medicare & Medicaid Services, of the Department of Health & Human Services, to enter into a contract to offer a Medicare Prescription Drug Plan (PDP), as described in the Medicare Prescription Drug Benefit Final Rule published in the Federal Register on January 28, 2005 (70 Fed. Reg. 4194). As part of the application process, KRS was required to establish a segregated Insolvency Account in the amount of \$100,000; this account must retain a minimum balance of \$100,000. The account consists of cash and/or cash equivalents and is invested on a daily basis. On February 19, 2009, KRS established the KRS Insurance Prescription Drug Fund at its custodial bank.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE P – REIMBURSEMENT OF RETIRED – REEMPLOYED HEALTH INSURANCE

As a result of the passage of House Bill 1 on September 1, 2008, if a retiree is reemployed in a regular full time position and has chosen health insurance coverage through KRS, the employer is required to reimburse KRS for the health insurance premium paid on the retiree's behalf, not to exceed the cost of the single premium rate. KRS has begun collecting these reimbursement payments. As of June 30, 2009, the reimbursement totaled \$206,859.

REQUIRED SUPPLEMENTARY INFORMATION

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedule of Funding Progress

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)-PENSION FUNDS

	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age Normal	Unfunded AAL (UAAL)	Percent Funded	Covered Payroll	UAAL as a % of Covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)	[(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 2002*	\$ 6,654,084,196	\$ 6,026,094,764	\$ (627,989,432)	110.4	\$ 1,595,809,458	(39.3)
June 30, 2003**	6,351,318,832	6,520,463,188	169,144,356	97.4	1,658,604,696	10.2
June 30, 2004**	6,000,513,743	7,049,613,171	1,049,099,428	85.1	1,645,412,496	63.8
June 30, 2005**	5,578,685,746	7,579,074,839	2,000,389,093	73.6	1,655,907,288	120.8
June 30, 2006**	5,394,086,323	8,994,826,247	3,600,739,924	60.0	1,702,230,777	211.5
June 30, 2007**	5,396,782,459	9,485,939,277	4,089,156,818	56.9	1,780,223,493	229.7
June 30, 2008**	5,318,792,893	10,129,689,985	4,810,897,092	52.5	1,837,873,488	261.8
June 30, 2009**	4,794,611,365	10,658,549,532	5,863,938,167	45.0	1,754,412,912	334.2
<u>Hazardous</u>						
June 30, 2002*	\$ 376,384,302	\$ 322,069,164	\$ (54,315,138)	116.9	\$ 125,275,925	(43.4)
June 30, 2003**	385,925,722	356,879,133	(29,046,589)	108.1	129,088,956	(22.5)
June 30, 2004**	397,212,763	403,578,036	6,365,273	98.4	126,664,812	5.0
June 30, 2005**	405,288,662	438,994,257	33,705,595	92.3	131,687,088	25.6
June 30, 2006**	427,984,192	508,655,903	80,671,711	84.1	138,747,320	58.1
June 30, 2007**	467,287,809	558,992,329	91,704,520	83.6	144,838,020	63.3
June 30, 2008**	502,132,214	618,010,827	115,878,613	81.2	148,710,060	77.9
June 30, 2009**	502,503,287	674,411,781	171,908,494	74.5	146,043,576	117.7
<u>Total</u>						
June 30, 2002*	\$ 7,030,468,498	\$ 6,348,163,928	\$ (682,304,570)	110.7	\$ 1,721,085,383	(39.6)
June 30, 2003**	6,737,244,554	6,877,342,321	140,097,767	98.0	1,787,693,652	7.8
June 30, 2004**	6,397,726,506	7,453,191,207	1,055,464,701	85.8	1,772,077,308	59.6
June 30, 2005**	5,983,974,408	8,018,069,096	2,034,094,688	74.6	1,787,594,376	113.8
June 30, 2006**	5,822,070,515	9,503,482,150	3,681,411,634	61.3	1,840,978,097	200.0
June 30, 2007**	5,864,070,268	10,044,931,606	4,180,861,338	58.4	1,925,061,513	217.2
June 30, 2008**	5,820,925,107	10,747,700,812	4,926,775,705	54.2	1,986,583,548	248.0
June 30, 2009**	5,297,114,652	11,332,961,313	6,035,846,661	46.7	1,900,456,488	317.6

*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 Funding Progress

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)-PENSION FUNDS

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)	L/AAL as a % of Covered Payroll (b-a)/c
<u>Non-Hazardous</u>						
June 30, 2002*	\$ 5,397,787,158	\$ 4,165,355,149	\$ (1,232,432,009)	129.6	\$ 1,663,183,629	(74.1)
June 30, 2003**	5,286,580,047	4,417,597,802	(868,982,245)	119.7	1,796,451,180	(48.4)
June 30, 2004**	5,187,851,530	4,936,459,488	(251,392,042)	105.1	1,826,870,880	(13.8)
June 30, 2005**	5,059,208,687	5,385,156,690	325,948,003	94.0	1,885,275,000	17.3
June 30, 2006**	5,162,894,136	6,179,569,267	1,016,675,131	83.5	1,982,437,473	51.3
June 30, 2007**	5,467,824,480	6,659,446,126	1,191,621,646	82.1	2,076,848,328	57.4
June 30, 2008**	5,731,502,438	7,304,217,691	1,572,715,253	78.5	2,166,612,648	72.6
June 30, 2009**	5,650,789,991	7,912,913,512	2,262,123,521	71.4	2,183,611,848	103.6
<u>Hazardous</u>						
June 30, 2002*	\$ 1,485,511,793	\$ 1,327,291,273	\$ (158,220,520)	111.9	\$ 345,849,277	(45.7)
June 30, 2003**	1,467,004,856	1,499,628,782	32,623,926	97.8	374,700,732	8.7
June 30, 2004**	1,457,612,042	1,640,830,120	183,218,078	88.8	392,562,624	46.7
June 30, 2005**	1,452,353,023	1,795,617,335	343,264,312	80.9	411,121,728	83.5
June 30, 2006**	1,515,075,017	2,020,142,770	505,067,753	75.0	426,927,550	118.3
June 30, 2007**	1,639,288,924	2,208,736,179	569,447,255	74.2	458,998,956	124.1
June 30, 2008**	1,750,867,373	2,403,122,095	652,254,722	72.9	474,241,332	137.5
June 30, 2009**	1,751,487,540	2,578,444,600	826,957,060	67.9	469,315,464	176.2
<u>Total</u>						
June 30, 2002*	\$ 6,883,298,951	\$ 5,492,646,422	\$ (1,390,652,529)	125.3	\$ 2,009,032,906	(69.2)
June 30, 2003**	6,753,584,903	5,917,226,584	(836,358,319)	114.1	2,171,151,912	(38.5)
June 30, 2004**	6,645,463,572	6,577,289,608	(68,173,964)	101.0	2,219,433,504	(3.1)
June 30, 2005**	6,511,561,710	7,180,774,025	669,212,315	90.7	2,296,396,728	29.2
June 30, 2006**	6,677,969,153	8,199,712,037	1,521,742,884	81.4	2,409,365,023	63.2
June 30, 2007**	7,107,113,404	8,868,182,305	1,761,068,901	80.1	2,535,847,284	69.4
June 30, 2008**	7,482,369,811	9,707,339,786	2,224,969,975	77.1	2,640,853,980	84.3
June 30, 2009**	7,402,277,531	10,491,358,112	3,089,080,581	70.6	2,652,927,312	116.4

*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 Funding Progress

STATE POLICE RETIREMENT SYSTEM (SPRS)-PENSION FUNDS

<u>Year Ended</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Entry Age Normal (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Percent Funded (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a % of Covered Payroll [(b-a)/c]</u>
June 30, 2002*	\$ 438,955,465	\$ 380,790,346	\$ (58,165,119)	115.3	\$ 44,314,696	(131.2)
June 30, 2003**	413,063,576	414,881,459	1,817,883	99.6	43,760,832	4.2
June 30, 2004**	385,077,195	437,482,425	52,405,230	88.0	43,835,208	119.6
June 30, 2005**	353,511,622	458,593,576	105,081,954	77.1	43,720,092	240.4
June 30, 2006**	344,016,197	516,482,298	172,466,101	66.6	47,743,865	361.2
June 30, 2007**	348,806,508	547,955,286	199,148,778	63.7	49,247,580	404.4
June 30, 2008**	350,891,451	587,129,257	236,237,806	59.8	53,269,080	443.5
June 30, 2009**	329,966,989	602,328,868	272,361,879	54.8	51,660,396	527.2

*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 Funding Progress

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)-INSURANCE FUND

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll {(b-a)/c}
<u>Non-Hazardous</u>						
June 30, 2002*	\$ 521,250,455	\$ 1,907,683,881	\$ 1,386,433,426	27.3	\$ 1,595,809,458	86.9
June 30, 2003**	553,885,082	2,093,210,321	1,539,325,239	26.5	1,658,604,696	92.8
June 30, 2004**	600,586,961	2,335,905,365	1,735,318,404	25.7	1,645,412,496	105.5
June 30, 2005**	607,068,351	2,680,559,188	2,073,490,837	22.7	1,655,907,288	125.2
June 30, 2006**	611,350,765	7,815,480,774	7,204,130,009	7.8	1,702,230,777	423.2
June 30, 2007**	621,171,658	5,201,355,055	4,580,183,397	11.9	1,780,223,493	257.3
June 30, 2008**	603,197,761	5,431,499,285	4,828,301,524	11.1	1,837,873,488	262.7
June 30, 2009**	534,172,580	4,507,325,571	3,973,152,991	11.9	1,754,412,912	226.5
<u>Hazardous</u>						
June 30, 2002*	\$ 135,874,582	\$ 236,819,050	\$ 100,944,468	57.4	\$ 125,275,925	80.6
June 30, 2003**	151,459,500	283,178,335	131,718,835	53.5	129,088,956	102.0
June 30, 2004**	169,158,879	323,503,563	154,344,684	52.3	126,664,812	121.9
June 30, 2005**	187,947,644	386,844,695	198,897,051	48.6	131,687,088	151.0
June 30, 2006**	212,833,318	621,237,856	408,404,538	34.3	138,747,320	294.4
June 30, 2007**	251,536,756	504,842,981	253,306,225	49.8	144,838,020	174.9
June 30, 2008**	288,161,759	541,657,214	253,495,455	53.2	148,710,060	170.5
June 30, 2009**	301,634,592	491,132,170	189,497,578	61.4	146,043,576	129.8
<u>Total</u>						
June 30, 2002*	\$ 657,125,037	\$ 2,144,502,931	\$ 1,487,377,894	30.6	\$ 1,721,085,383	86.4
June 30, 2003**	705,344,582	2,376,388,656	1,671,044,074	29.7	1,787,693,652	93.5
June 30, 2004**	769,745,840	2,659,408,928	1,889,663,088	28.9	1,772,077,308	106.6
June 30, 2005**	795,015,995	3,067,403,883	2,272,387,888	25.9	1,787,594,376	127.1
June 30, 2006**	824,184,083	8,436,718,630	7,612,534,547	9.8	1,840,178,097	413.5
June 30, 2007**	872,708,414	5,706,198,036	4,833,489,622	15.3	1,925,061,513	251.1
June 30, 2008**	891,359,520	5,973,156,499	5,081,796,979	14.9	1,986,583,548	255.8
June 30, 2009**	835,807,172	4,998,457,741	4,162,650,569	16.7	1,900,456,488	219.0

*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 Funding Progress

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)-INSURANCE FUND

	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Targeted Rate	Unfunded AAL (UAAL)	Percent Funded	Covered Payroll	UAAL as a % of Covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)	[(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 2002*	\$ 450,497,307	\$ 1,977,577,038	\$ 1,527,079,731	22.8	\$ 1,663,183,629	91.8
June 30, 2003**	520,060,105	2,176,963,259	1,656,903,154	23.9	1,796,451,180	92.2
June 30, 2004**	585,399,072	2,438,734,696	1,853,335,624	24.0	1,826,870,880	101.5
June 30, 2005**	663,941,949	2,788,754,654	2,124,812,705	23.8	1,885,275,000	112.7
June 30, 2006**	777,726,590	4,607,223,639	3,829,497,049	16.9	1,982,437,473	193.2
June 30, 2007**	960,285,900	3,333,966,070	2,373,680,170	28.8	2,076,848,328	114.3
June 30, 2008**	1,168,883,170	3,583,193,466	2,414,310,296	32.6	2,166,612,648	111.4
June 30, 2009**	1,216,631,769	3,070,386,018	1,853,754,249	39.6	2,183,611,848	84.9
<u>Hazardous</u>						
June 30, 2002*	\$ 234,683,878	\$ 781,184,974	\$ 546,501,096	30.1	\$ 345,849,279	158.0
June 30, 2003**	269,190,080	935,650,662	666,460,582	28.8	374,700,732	177.9
June 30, 2004**	310,578,162	1,025,684,477	715,106,315	30.3	392,562,624	182.2
June 30, 2005**	359,180,461	1,283,299,092	924,118,631	28.0	411,121,728	224.8
June 30, 2006**	422,785,042	1,928,481,371	1,505,696,329	21.9	426,927,550	352.7
June 30, 2007**	512,926,549	1,646,460,011	1,133,533,462	31.2	458,998,956	247.0
June 30, 2008**	613,526,319	1,769,782,957	1,156,256,638	34.7	474,241,332	243.8
June 30, 2009**	651,130,782	1,593,548,263	942,417,481	40.9	469,315,464	200.8
<u>Total</u>						
June 30, 2002*	\$ 685,181,185	\$ 2,758,762,012	\$ 2,073,580,827	24.8	\$ 2,009,032,908	103.2
June 30, 2003**	789,250,185	3,112,613,921	2,323,363,736	25.4	2,171,151,912	107.0
June 30, 2004**	895,977,234	3,464,419,173	2,568,441,939	25.9	2,219,433,504	115.7
June 30, 2005**	1,023,122,410	4,072,053,746	3,048,931,336	25.1	2,296,396,728	132.8
June 30, 2006**	1,200,511,632	6,535,705,010	5,335,193,378	18.4	2,409,365,023	221.4
June 30, 2007**	1,473,212,449	4,980,426,081	3,507,213,632	29.6	2,535,847,284	138.3
June 30, 2008**	1,782,409,489	5,352,976,423	3,570,566,934	33.3	2,640,853,980	135.2
June 30, 2009**	1,867,762,551	4,663,934,281	2,796,171,730	40.0	2,652,927,312	105.4

*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 Funding Progress

STATE POLICE RETIREMENT SYSTEM (SPRS)-INSURANCE FUND

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Targeted Rate (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll [(b-a)/c]
June 30, 2002*	\$ 86,867,391	\$ 165,445,412	\$ 78,578,021	52.5	\$ 44,314,696	177.3
June 30, 2003**	90,747,967	184,501,205	93,753,238	49.2	43,760,832	214.2
June 30, 2004**	96,622,908	197,604,301	100,981,393	48.9	43,835,208	230.4
June 30, 2005**	100,207,082	234,159,510	133,952,428	42.8	43,720,092	306.4
June 30, 2006**	105,580,269	582,580,867	477,000,598	18.1	47,743,865	999.1
June 30, 2007**	115,215,912	432,763,229	317,547,317	26.6	49,247,580	644.8
June 30, 2008**	123,961,197	445,107,468	321,146,271	27.8	53,269,080	602.9
June 30, 2009**	123,526,647	364,031,141	240,504,494	33.9	51,660,396	465.5

*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 Contributions From Employers and Other Contributing Entities

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)

NON-HAZARDOUS EMPLOYEES

Pension				
Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$	\$ 1,760,328	\$	%
June 30, 2003	4,905,399	7,597,450		154.9
June 30, 2004	47,739,067	21,696,543		45.4
June 30, 2005	85,798,943	50,332,750		58.7
June 30, 2006	129,125,800	60,680,607		47.0
June 30, 2007	176,774,106	88,248,677		49.9
June 30, 2008	264,742,985	104,655,217		39.5
June 30, 2009	294,495,010	112,383,083		38.2

Insurance				
Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 93,993,177	\$ 93,912,017	\$	99.9%
June 30, 2003	92,052,561	65,335,219		71.0
June 30, 2004	77,951,553	78,016,737		100.1
June 30, 2005	86,974,271	49,909,228		57.4
June 30, 2006	202,498,302	47,634,639		23.5
June 30, 2007	219,768,964	64,014,332	10,744,049	34.0
June 30, 2008	558,745,820	56,744,942	6,633,538	11.3
June 30, 2009	362,707,378	74,542,932	8,167,982	22.8

Total				
Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 93,993,177	\$ 95,672,345	\$	101.8%
June 30, 2003	96,957,960	72,932,669		75.2
June 30, 2004	125,690,620	99,713,280		79.3
June 30, 2005	172,773,214	100,241,978		58.0
June 30, 2006	331,624,102	108,315,246		32.7
June 30, 2007	396,543,070	152,263,009	10,744,049	41.1
June 30, 2008	823,488,805	161,400,159	6,633,538	20.4
June 30, 2009	657,202,388	186,926,015	8,167,982	29.7

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedule of Contributions From Employers and Other Contributing Entities

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS) HAZARDOUS EMPLOYEES

Pension

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 7,742,052	\$ 7,933,817	\$	102.5%
June 30, 2003	8,511,402	7,322,607		86.0
June 30, 2004	9,600,978	9,769,580		101.8
June 30, 2005	9,449,878	9,758,547		103.3
June 30, 2006	10,787,472	10,803,206		100.1
June 30, 2007	12,219,689	13,237,321		108.3
June 30, 2008	14,147,341	15,257,079		107.8
June 30, 2009	15,708,254	15,843,289		100.9

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 15,859,932	\$ 15,887,399	\$	100.2%
June 30, 2003	15,839,215	15,883,263		100.3
June 30, 2004	14,942,092	14,959,617		100.1
June 30, 2005	15,892,977	15,395,977		96.9
June 30, 2006	28,517,563	17,011,745		59.7
June 30, 2007	31,304,778	19,534,819	104,669	62.7
June 30, 2008	51,214,929	21,997,341	73,891	43.1
June 30, 2009	34,670,467	20,807,204	186,081	60.6

Total

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 23,601,984	\$ 23,821,216	\$	100.9
June 30, 2003	24,350,617	23,205,870		95.3
June 30, 2004	24,543,070	24,729,197		100.8
June 30, 2005	25,342,855	25,154,524		99.3
June 30, 2006	39,305,035	27,814,951		70.8
June 30, 2007	43,524,467	32,772,140	104,669	75.3
June 30, 2008	65,362,270	37,254,420	73,891	57.1
June 30, 2009	50,378,721	36,650,493	186,081	73.1

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedule of Contributions From Employers and Other Contributing Entities

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)

NON-HAZARDOUS EMPLOYEES

Pension

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 3,326,367	\$ 5,528,348	\$	166.2%
June 30, 2003	8,682,257	11,855,694		136.6
June 30, 2004	43,111,505	44,028,465		102.1
June 30, 2005	53,117,955	54,616,800		102.8
June 30, 2006	83,123,669	90,834,052		109.3
June 30, 2007	112,508,305	124,260,850		110.4
June 30, 2008	138,311,398	150,925,334		109.1
June 30, 2009	161,097,151	179,284,551		111.3

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 102,119,475	\$ 102,150,543	\$	100.0%
June 30, 2003	102,038,427	99,234,843		97.3
June 30, 2004	89,289,520	89,344,241		100.1
June 30, 2005	106,612,633	106,638,253		100.0
June 30, 2006	272,942,757	128,867,817		47.2
June 30, 2007	285,600,490	147,608,801	9,623,431	55.1
June 30, 2008	406,541,729	196,110,111	6,003,181	49.7
June 30, 2009	264,733,532	123,761,611	7,623,628	49.6

Total

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 105,445,842	\$ 107,678,891	\$	102.1%
June 30, 2003	110,720,684	111,090,537		100.3
June 30, 2004	132,401,025	133,372,706		100.7
June 30, 2005	159,730,588	161,255,053		101.0
June 30, 2006	356,066,426	219,701,869		61.7
June 30, 2007	398,108,795	271,869,651	9,623,431	70.7
June 30, 2008	544,853,127	347,035,445	6,003,181	64.8
June 30, 2009	425,830,683	303,046,162	7,623,628	72.9

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedule of Contributions From Employers and Other Contributing Entities

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)

HAZARDOUS

Pension

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 10,582,988	\$ 11,054,949	\$	104.5%
June 30, 2003	19,920,223	16,905,556		84.9
June 30, 2004	27,050,382	27,640,775		102.2
June 30, 2005	39,437,725	39,947,747		101.3
June 30, 2006	44,059,404	49,976,485		113.4
June 30, 2007	53,889,838	61,553,118		114.2
June 30, 2008	64,082,063	72,154,734		112.6
June 30, 2009	69,056,365	78,151,677		113.2

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 45,721,274	\$ 45,730,333	\$	100.0%
June 30, 2003	43,502,755	45,243,950		104.0
June 30, 2004	47,018,046	47,036,777		100.0
June 30, 2005	54,094,495	54,106,577		100.0
June 30, 2006	98,297,535	64,853,778		66.0
June 30, 2007	115,938,899	70,072,785	656,523	61.0
June 30, 2008	168,723,639	90,113,200	419,774	53.7
June 30, 2009	126,757,348	70,785,241	627,938	56.3

Total

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 56,304,262	\$ 56,785,282	\$	100.9%
June 30, 2003	63,422,978	62,149,506		98.0
June 30, 2004	74,068,428	74,677,552		100.8
June 30, 2005	93,532,220	94,054,324		100.6
June 30, 2006	142,356,939	114,830,263		80.7
June 30, 2007	169,828,737	131,625,903	656,523	77.9
June 30, 2008	232,805,702	162,267,934	419,774	70.0
June 30, 2009	195,813,713	148,936,918	627,938	76.4

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedule of Contributions From Employers and Other Contributing Entities

STATE POLICE RETIREMENT SYSTEM (SPRS)

Pension				
Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$	\$ (17,643)	\$	%
June 30, 2003		(20,061)		
June 30, 2004	1,175,711	1,152,752		98.0
June 30, 2005	3,730,805	2,851,461		76.4
June 30, 2006	6,352,777	4,244,445		66.8
June 30, 2007	9,023,665	6,142,326		68.1
June 30, 2008	13,823,490	7,443,277		53.8
June 30, 2009	15,951,841	8,186,259		51.3

Insurance				
Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 9,563,111	\$ 9,579,899	\$	100.1%
June 30, 2003	9,443,588	9,654,313		102.2
June 30, 2004	8,434,834	8,455,498		100.2
June 30, 2005	8,608,536	6,631,031		77.0
June 30, 2006	12,554,648	6,880,517		54.8
June 30, 2007	15,233,320	6,488,600	361,942	45.0
June 30, 2008	43,469,735	7,329,229	183,564	17.3
June 30, 2009	29,324,666	7,413,552	229,240	26.1

Total				
Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2002	\$ 9,563,111	\$ 9,562,256	\$	100.0%
June 30, 2003	9,443,588	9,634,252		102.0
June 30, 2004	9,610,545	9,608,250		100.0
June 30, 2005	12,339,341	9,482,492		76.8
June 30, 2006	18,907,425	11,124,962		58.8
June 30, 2007	24,256,985	12,630,926	361,942	53.6
June 30, 2008	57,293,225	14,772,506	183,564	26.0
June 30, 2009	45,276,507	15,599,811	229,240	34.9

ADDITIONAL SUPPORTING SCHEDULES

KENTUCKY RETIREMENT SYSTEMS

Schedule of Administrative Expenses

For the Fiscal Years Ended June 30, 2009 and 2008

	2009	2008
	(Dollars in thousands)	
Personal Services		
Salaries and Per Diem	\$ 13,323	\$ 12,339
Fringe Benefits	3,964	3,445
Tuition Assistance	62	56
Total Personal Services	17,349	15,840
Contractual Services		
Actuarial	263	474
Audit	49	49
Legal	231	843
Medical	298	222
Contractual	755	774
Total Contractual Services	1,596	2,362
Communication		
Printing	433	325
Telephone	170	138
Postage	655	634
Travel	166	205
Total Communication	1,424	1,302
Rentals		
Office Space	1,057	1,056
Equipment	97	86
Total Rentals	1,154	1,142
Miscellaneous		
Utilities	191	258
Supplies	220	230
Insurance	80	64
Maintenance	11	642
Other	1,418	569
Total Miscellaneous	1,920	1,763
Depreciation/Amortization	525	498
Total Pension Fund Administrative Expense	23,968	22,907
Healthcare Administrative Fees	8,869	7,477
Total Administrative Expenses	\$ 32,837	\$ 30,384

KENTUCKY RETIREMENT SYSTEMS

Schedule of Investment Expenses

For the Fiscal Years Ended June 30, 2009 and 2008

PENSION FUNDS	<u>2009</u>	<u>2008</u>
	(Dollars in thousands)	
Security Lending Fees		
Broker Rebates	\$ 19,498	\$ 115,960
Lending Agent Fees	<u>3,683</u>	<u>4,950</u>
Total Security Lending	23,181	120,910
Common Stock Commissions	8,342	7,915
Contractual Services		
Investment Management	12,440	12,273
Security Custody	208	209
Investment Consultant	621	231
Investment Related Travel	<u>32</u>	<u>37</u>
Total Contractual Services	13,301	12,750
INSURANCE FUND		
Security Lending Fees		
Broker Rebates	3,951	27,476
Lending Agent Fees	<u>695</u>	<u>1,008</u>
Total Security Lending	4,646	28,484
Common Stock Commissions	929	1,249
Contractual Services		
Investment Management	1,214	1,702
Security Custody	42	41
Investment Consultant	120	46
Investment Related Travel	<u>7</u>	<u>7</u>
Total Contractual Services	<u>1,383</u>	<u>1,796</u>
Total Investment Expenses	<u>\$ 51,782</u>	<u>\$ 173,104</u>

KENTUCKY RETIREMENT SYSTEMS

Schedule of Professional Consultant Fees

For the Fiscal Years Ended June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
	(Dollars in thousands)	
Actuarial Services	\$ 263	\$ 474
Medical Review Services	298	221
Audit Services	49	49
Legal Counsel	231	843
Compliance	105	120
Workflow	433	424
Healthcare	82	17
Banking	51	48
Human Resource	26	104
Miscellaneous	<u>58</u>	<u>62</u>
Total	<u>\$ 1,596</u>	<u>\$ 2,362</u>

DEAN DORTON FORD

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER
MATTERS 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 fiscal year ended June 30, 2009, and have issued our report thereon dated November 10, 2009. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Kentucky Retirement Systems' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Kentucky Retirement Systems' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Kentucky Retirement Systems' internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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Compliance and Other Matters

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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of the audit committee, management, and the Commonwealth of Kentucky 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.

A handwritten signature in black ink that reads "Dean Dorton Ford, ASC". The signature is written in a cursive, flowing style.

November 10, 2009
Lexington, Kentucky

KENTUCKY RETIREMENT SYSTEMS

Schedule of Finding and Response

CURRENT YEAR

Our audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.