

KENTUCKY RETIREMENT SYSTEMS

Financial Statements and Supplementary Information

*For the Fiscal Years Ended June 30, 2011 and 2010
With Independent Auditors' Report Thereon*



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DEAN || DORTON || ALLEN || FORD^{PC}

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 year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the Kentucky Retirement Systems' management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Kentucky Retirement Systems as of and for the fiscal year ended June 30, 2010, were audited by Dean, Dorton and Ford, PSC, whose report dated November 18, 2010, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of June 30, 2011 and the changes in plan net assets for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 17, 2011, 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 59 through 69) are not a required part of the basic financial statements, but are supplementary information required by accounting

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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.

Our audit was conducted for the purpose of forming an opinion on the 2011 financial statements taken as a whole. The additional supporting schedules (pages 70 through 72) are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such 2011 information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 2011 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The additional supporting schedules, as of and for the fiscal year ended June 30, 2010, were audited by Dean, Dorton and Ford, PSC, whose report dated November 18, 2010, expressed an opinion that the fiscal year 2010 additional supporting schedules were fairly stated in all material respects in relation to the fiscal year 2010 financial statements taken as a whole.

Dean Dorton Allen Ford, PLLC

November 17, 2011
Lexington, Kentucky

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis

June 30, 2011

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, 2011. 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 increased by \$1,140.2 million during fiscal 2011.
- Member and Employer contributions reported for fiscal 2011, totaled \$882.1 million compared to \$714.4 million in fiscal 2010. 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.
- The net appreciation in the fair value of investments was \$1,658.5 million for the fiscal year ended June 30, 2011 compared to net appreciation of \$1,283.9 million for the prior fiscal year. Included in this net appreciation were realized gains on sales of investments of \$951 million. The increase in realized gains experienced by the pension funds is due to favorable market conditions.
- Interest, dividend and net securities lending income was \$300.9 million compared to \$266.4 million in fiscal 2010.
- Pension benefits paid to retirees and beneficiaries totaled \$1,591.5 million compared to \$1,516.1 million in prior year. Refund of contributions paid to former members upon termination of employment totaled \$27.5 million compared to \$22.3 million in the prior year.
- Administrative expense totaled \$24.9 million compared to \$24.8 million in the prior fiscal year. Capital Project Expenses incurred, as a result of the START Project, totaled \$195,000. Capital Project Expenses in prior years were capitalized between fixed assets and intangible assets, as appropriate. Costs incurred in fiscal 2011 were deemed to be non-capitalizable.
- The member health insurance contribution, as a result of the passage of House Bill 1 (effective September 1, 2008) totaled \$7.1 million, for the fiscal year ended June 30, 2011, compared to \$3.4 million in the prior fiscal year.

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2011

Financial Highlights-Insurance Fund

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

- The combined plan net assets of the insurance fund administered by Kentucky Retirement Systems increased by \$670.8 million during fiscal 2011.
- Premiums received from retirees who participated in the Medicare eligible self-funded plan totaled \$30.9 million, compared to \$29.1 million in the prior fiscal year.
- Employer contributions of \$435.9 million were received compared to \$371.9 million in fiscal 2010. This increase is due to an increase in the insurance contribution rate.
- The Employer Group Waiver Plan receipts totaled \$22.1 million compared to \$19.8 million in fiscal 2010.
- The net appreciation in the fair value of investments was \$517.0 million compared to net appreciation of \$274.3 million for the prior fiscal year. Included in this net appreciation were realized gains on sales of investments of \$347.8 million. This increase in realized gains is due to favorable market conditions.
- Interest, dividend and net securities lending income was \$53.1 million compared to \$42.3 million in fiscal 2010.
- Premiums paid by the fund for hospital and medical insurance coverage (under age 65) totaled \$242.8 million. Payments for the self-funded healthcare reimbursements (over age 65) totaled \$130.3 million. The total of insurance premiums paid plus self-funded reimbursements was \$373.1 million for fiscal 2011. Insurance premiums paid plus self-funded healthcare reimbursements for the prior plan year totaled \$353.5 million.

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2011

Financial Highlights-Insurance Fund, continued

- 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, Kentucky Retirement Systems 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 balance as of June 30, 2011, totaled \$101,000.
- The reimbursement of retired-reemployed health insurance, as a result of the passage of House Bill 1 (effective September 1, 2008) totaled \$4.0 million for the fiscal year ended June 30, 2011, compared to \$2.0 million in the prior fiscal year.

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, 2011. 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 2011.

The Schedule of Funding Progress, on pages 59-64, 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 65-69, 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, 2011

Kentucky Retirement Systems As A Whole

Kentucky Retirement Systems' combined plan net assets increased, during the fiscal year ended June 30, 2011, by \$1,811 million from \$12,966.4 million to \$14,777.4 million. Plan net assets for the prior fiscal year increased by \$1,028.5 million. The increase in plan net assets for the plan year ended June 30, 2011 is primarily attributable to favorable market conditions. The analysis below focuses on plan net assets (Table 1) and changes in plan net assets (Table 2) of Kentucky Retirement Systems' Pension and Insurance Funds.

Table 1
Plan Net Assets
(In Millions)

	Pension Funds			Insurance Fund			Total		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
Cash & Invest.	\$ 13,217.4	\$ 12,690.2	\$ 11,645.5	\$ 3,458.4	\$ 2,961.3	\$ 2,460.2	\$ 16,675.8	\$ 15,651.5	\$ 14,105.7
Receivables	178.1	108.6	113.9	80.8	33.6	38.7	258.9	142.2	152.6
Equip/Int Assets, net of dep/amort.	9.7	9.3	8.1				9.7	9.3	8.1
Total Assets	13,405.2	12,808.1	11,767.5	3,539.2	2,994.9	2,498.9	16,944.4	15,803.0	14,266.4
Total Liabilities	(1,724.6)	(2,267.7)	(1,885.8)	(442.4)	(568.9)	(442.7)	(2,167.0)	(2,836.6)	(2,328.5)
Plan Net Assets	\$ 11,680.6	\$ 10,540.4	\$ 9,881.7	\$ 3,096.8	\$ 2,426.0	\$ 2,056.2	\$ 14,777.4	\$ 12,966.4	\$ 11,937.9

Table 2
Changes in Plan Net Assets
(In Millions)

	Pension Funds			Insurance Fund			Total		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
Additions:									
Member Cont.	\$ 326.9	\$ 249.8	\$ 290.8	\$ -	\$ -	\$ -	\$ 326.9	\$ 249.8	\$ 290.8
Employer Cont.	548.1	461.2	393.8	436.0	371.9	297.2	984.1	833.1	691.0
Heath Ins. Cont.	7.1	3.4	0.9				7.1	3.4	0.9
Premiums Rec'd				31.0	29.1	27.1	31.0	29.1	27.1
Retired Remp Ins.				4.0	2.0	0.2	4.0	2.0	0.2
Medicare Subsidy				22.1	19.8	16.8	22.1	19.8	16.8
Invest. Inc. (net)	1,902.2	1,507.5	(2,232.9)	561.2	310.1	(611.3)	2,463.4	1,817.6	(2,844.2)
Total Additions	2,784.3	2,221.9	(1,547.4)	1,054.3	732.9	(270.0)	3,838.6	2,954.8	(1,817.4)
Deductions:									
Benefit payments	1,591.5	1,516.1	1,478.7				1,591.5	1,516.1	1,478.7
Refunds	27.5	22.3	23.6				27.5	22.3	23.6
Administrative Ex.	24.9	24.8	24.0	10.4	9.7	8.8	35.3	34.5	32.8
Capital Projects Ex.	0.2						0.2		
Healthcare Costs				373.1	353.4	312.9	373.1	353.4	312.9
Total Deductions	1,644.1	1,563.2	1,526.3	383.5	363.1	321.7	2,027.6	1,926.3	1,848.0
Inc. (Decrease) in Plan Net Assets	\$ 1,140.2	\$ 658.7	\$ (3,073.7)	\$ 670.8	\$ 369.8	\$ (591.7)	\$ 1,811.0	\$ 1,028.5	\$ (3,665.4)

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2011

Kentucky Retirement Systems As A Whole, continued

Plan net assets of the pension funds increased by \$1,140.2 million (\$11,680.6 million compared to \$10,540.4 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 increase is attributable primarily to favorable market conditions.

Plan net assets of the insurance fund increased by \$670.8 million (\$3,096.8 million compared to \$2,426.0 million). All of these assets are restricted in use to provide hospital and medical insurance benefits to members of the pension funds who receive a monthly retirement allowance. This increase in net plan assets is primarily attributable to favorable market conditions.

Pension Fund Activities

Member contributions increased by \$77.1 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.

Employer contributions increased by \$86.9 million due to the increase in covered payroll reported to Kentucky Retirement Systems and the increase in the employer contribution rate applied to covered payroll.

Net investment income increased by \$394.7 million (\$1,902.2 million compared to \$1,507.5 million in the prior year). The pension funds experienced an increase in income primarily due to the increase in fair value of investments. This can be illustrated in Table 3 as follows:

Investment Income (Loss) -Pension	In Millions		
	2011	2010	2009
Increase (decrease) in fair value of investments	\$ 707	\$ 1,066	\$ (1,788)
Investment income net of investment expense	244	224	305
Gain (loss) on sale of investments	951	218	(750)
Net investment income (loss)	<u>\$ 1,902</u>	<u>\$ 1,508</u>	<u>\$ (2,233)</u>

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2011

Pension Fund Activities, continued

Pension fund deductions increased by \$80.9 million caused principally by an increase of \$73.3 million in benefit payments. Retirees received a Cost of Living Adjustment (COLA) increase of 1.5% in benefit payments as of July 1, 2010. Refunds of member contributions increased by \$5.2 million and administrative expenses increased by \$0.1 million. Capital Project Expenses, incurred as a result of the START Project, totaled \$0.2 million. These costs were capitalized in prior years, however, in fiscal 2011 these costs were deemed uncapitalizable.

Insurance Fund Activities

Employer contributions paid into the insurance fund increased by \$64.1 million over the prior fiscal year. This increase is a result of the increase in the employer contribution rate applied to covered payroll.

Net investment income increased by \$251.1 million. This increase in net income is due primarily to the increase in the gains on sale of investments. This can be illustrated in Table 4 as follows:

Investment Income (Loss)-Insurance	In Millions		
	2011	2010	2009
Increase (decrease) in fair value of investments	\$ 169	\$ 183	\$ (451)
Investment income net of investment expense	44	35	45
Gain (loss) on sale of investments	348	92	(205)
Net investment income (loss)	<u>\$ 561</u>	<u>\$ 310</u>	<u>\$ (611)</u>

Insurance fund deductions increased by \$20.4 million due to the increase in overall healthcare costs.

KENTUCKY RETIREMENT SYSTEMS

Management's Discussion and Analysis, continued

June 30, 2011

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 59-64. The asset value stated in the Schedule of Funding Progress is the actuarial value of assets. The actuarial value of assets recognizes a portion of the difference between the market value of assets and the expected market value of assets, based on the investment return assumption. The amount recognized each year is 20% of the difference between market value and expected market value. 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 \$1,259.8 million for a total unfunded amount of \$12,382.5 million for the fiscal year ended June 30, 2011, compared to an unfunded amount of \$11,122.7 million for the fiscal year ended June 30, 2010. 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, 2011, decreased to \$6,837.7 million from \$7,334.7 million for the plan year ended June 30, 2010. This is a decrease in the unfunded actuarial accrued liability of \$497 million.

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 65-69. 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, 2011 (with Comparative Totals As of June 30, 2010)

(Dollars in Thousands)

	2011					2010	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
ASSETS							
Cash and Short-Term Investments							
Cash	\$ 240	\$ 957	\$ 464	\$ 787	\$ 292	\$ 2,740	\$ 2,035
Short-Term Investments	<u>68,087</u>	<u>319,900</u>	<u>234,803</u>	<u>658,095</u>	<u>28,452</u>	<u>1,309,337</u>	<u>601,101</u>
Total Cash and Short-Term Investments	68,327	320,857	235,267	658,882	28,744	1,312,077	603,136
Receivables							
Contributions	3,955	34,554	20,088	78,252	1,959	138,808	66,984
Investment Income	<u>1,602</u>	<u>12,091</u>	<u>5,711</u>	<u>18,932</u>	<u>974</u>	<u>39,310</u>	<u>41,636</u>
Total Receivables	5,557	46,645	25,799	97,184	2,933	178,118	108,620
Investments, at fair value							
Corporate and Government Bonds	116,192	884,790	415,501	1,394,596	71,812	2,882,891	2,502,572
Equity Contracts	25,195	297,997	41,703	499,558	4,343	868,796	374,327
Interest Rate Contracts	10,690	126,431	17,693	211,947	1,843	368,604	236,424
Corporate Stocks	253,716	1,625,996	915,061	2,335,680	150,201	5,280,654	6,104,950
Mortgages	27,790	230,767	104,177	369,658	19,061	751,453	593,521
Real Estate	<u>3,394</u>	<u>8,767</u>	<u>6,198</u>	<u>12,958</u>	<u>935</u>	<u>32,252</u>	<u>15,075</u>
Total Investments, at fair value	436,977	3,174,748	1,500,333	4,824,397	248,195	10,184,650	9,826,869
Securities Lending Collateral Invested	75,427	521,479	259,983	822,399	41,307	1,720,595	2,260,141
Equipment (net of accumulated depreciation)	113	1,339	202	2,304	26	3,984	3,871
Intangible Assets (net of accumulated amortization)	<u>169</u>	<u>1,947</u>	<u>286</u>	<u>3,310</u>	<u>32</u>	<u>5,744</u>	<u>5,484</u>
Total Assets	<u>586,570</u>	<u>4,067,015</u>	<u>2,021,870</u>	<u>6,408,476</u>	<u>321,237</u>	<u>13,405,168</u>	<u>12,808,121</u>
LIABILITIES							
Accounts Payable	58	1,294	29	2,626	3	4,010	7,541
Securities Lending Collateral Obligations	<u>75,427</u>	<u>521,479</u>	<u>259,983</u>	<u>822,399</u>	<u>41,307</u>	<u>1,720,595</u>	<u>2,260,141</u>
Total Liabilities	<u>75,485</u>	<u>522,773</u>	<u>260,012</u>	<u>825,025</u>	<u>41,310</u>	<u>1,724,605</u>	<u>2,267,682</u>
Plan Net Assets Held in Trust for Pension Benefits							
	<u>\$ 511,085</u>	<u>\$ 3,544,242</u>	<u>\$ 1,761,858</u>	<u>\$ 5,583,451</u>	<u>\$ 279,927</u>	<u>\$ 11,680,563</u>	<u>\$ 10,540,439</u>

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, 2011 (with Comparative Totals For the Fiscal Year Ended June 30, 2010)

(Dollars in Thousands)

	2011					2010	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
ADDITIONS							
Members' Contributions	\$ 12,959	\$ 109,879	\$ 53,918	\$ 144,861	\$ 5,225	\$ 326,842	\$ 249,775
Employers' Contributions	18,085	185,558	84,595	247,968	11,920	548,126	461,161
Health Insurance Contributions (HB1)	<u>241</u>	<u>2,441</u>	<u>1,157</u>	<u>3,216</u>	<u>31</u>	<u>7,086</u>	<u>3,448</u>
Total Contributions	31,285	297,878	139,670	396,045	17,176	882,054	714,384
INVESTMENT INCOME							
From Investing Activities:							
Net Appreciation in							
Fair Value of Investments	73,813	521,475	252,410	772,005	38,845	1,658,548	1,283,982
Interest/Dividends	<u>11,844</u>	<u>97,186</u>	<u>49,178</u>	<u>128,434</u>	<u>9,907</u>	<u>296,549</u>	<u>260,673</u>
Total Investing Activities Income	85,657	618,661	301,588	900,439	48,752	1,955,097	1,544,655
Investment Expense	2,056	17,622	14,534	11,451	3,912	49,575	35,427
Commissions	<u>300</u>	<u>2,551</u>	<u>1,026</u>	<u>3,562</u>	<u>204</u>	<u>7,643</u>	<u>7,374</u>
Total Investing Activities Expense	<u>2,356</u>	<u>20,173</u>	<u>15,560</u>	<u>15,013</u>	<u>4,116</u>	<u>57,218</u>	<u>42,801</u>
Net Income from Investing Activities	<u>83,301</u>	<u>598,488</u>	<u>286,028</u>	<u>885,426</u>	<u>44,636</u>	<u>1,897,879</u>	<u>1,501,854</u>
From Securities Lending Activities:							
Securities Lending Income	342	2,344	1,180	3,731	186	7,783	8,890
Securities Lending Expense:							
Security Borrower Rebates	100	690	344	1,088	55	2,277	1,755
Security Lending Agent Fees	<u>51</u>	<u>352</u>	<u>176</u>	<u>555</u>	<u>28</u>	<u>1,162</u>	<u>1,445</u>
Net Income from Securities Lending Activities	<u>191</u>	<u>1,302</u>	<u>660</u>	<u>2,088</u>	<u>103</u>	<u>4,344</u>	<u>5,690</u>
Total Net Investment Income	<u>83,492</u>	<u>599,790</u>	<u>286,688</u>	<u>887,514</u>	<u>44,739</u>	<u>1,902,223</u>	<u>1,507,544</u>
Total Additions	114,777	897,668	426,358	1,283,559	61,915	2,784,277	2,221,928

KENTUCKY RETIREMENT SYSTEMS

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

For the Fiscal Year Ended June 30, 2011 (with Comparative Totals For the Fiscal Year Ended June 30, 2010)

(Dollars in Thousands)

	2011					2010	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
DEDUCTIONS							
Benefit Payments	44,509	838,372	167,540	494,344	46,754	1,591,519	1,516,064
Refunds	2,062	10,931	2,654	11,816	58	27,521	22,274
Administrative Expenses	721	8,558	1,191	14,324	124	24,918	24,848
Capital Project Expenses	<u>6</u>	<u>67</u>	<u>9</u>	<u>112</u>	<u>1</u>	<u>195</u>	<u> </u>
Total Deductions	<u>47,298</u>	<u>857,928</u>	<u>171,394</u>	<u>520,596</u>	<u>46,937</u>	<u>1,644,153</u>	<u>1,563,186</u>
Net Increase in Plan Assets	67,479	39,740	254,964	762,963	14,978	1,140,124	658,742
Plan Net Assets Held in Trust for Pension Benefits							
Beginning of Year	<u>443,606</u>	<u>3,504,502</u>	<u>1,506,894</u>	<u>4,820,488</u>	<u>264,949</u>	<u>10,540,439</u>	<u>9,881,697</u>
End of Year	<u>\$ 511,085</u>	<u>\$ 3,544,242</u>	<u>\$ 1,761,858</u>	<u>\$ 5,583,451</u>	<u>\$ 279,927</u>	<u>\$ 11,680,563</u>	<u>\$ 10,540,439</u>

See accompanying notes to the financial statements.

KENTUCKY RETIREMENT SYSTEMS

Combined Statement of Plan Net Assets-Insurance Fund

As of June 30, 2011 (with Comparative Totals As of June 30, 2010)

(Dollars in Thousands)

	2011					2010	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
ASSETS							
Cash and Short-Term Investments							
Cash	\$ 98	\$ 943	\$ 29	\$ 922	\$ 24	\$ 2,016	\$ 1,028
Short-Term Investments	78,770	90,548	199,213	361,230	29,132	758,893	535,637
Medicare Drug Deposit	<u>11</u>	<u>20</u>	<u>23</u>	<u>42</u>	<u>5</u>	<u>101</u>	<u>100</u>
Total Cash and Short-Term Investments	78,879	91,511	199,265	362,194	29,161	761,010	536,765
Receivables							
Contributions	922	9,508	17,463	43,242	591	71,726	25,655
Investment Income	<u>961</u>	<u>1,283</u>	<u>2,234</u>	<u>4,200</u>	<u>388</u>	<u>9,066</u>	<u>7,966</u>
Total Receivables	1,883	10,791	19,697	47,442	979	80,792	33,621
Investments, at fair value							
Corporate and Government Bonds	63,286	78,502	148,241	277,636	25,924	593,589	276,627
Equity Contracts	15,291	180,855	25,309	303,183	2,636	527,274	426,809
Interest Rate Contracts	974	11,519	1,612	19,311	168	33,584	
SWAPs	10	113	15	188	2	328	
Corporate Stocks	147,600	41,591	349,177	382,943	63,413	984,724	1,155,445
Mortgages	12,480	14,994	29,248	54,779	4,946	116,447	
Real Estate	<u>272</u>	<u>476</u>	<u>579</u>	<u>1,080</u>	<u>116</u>	<u>2,523</u>	<u>615</u>
Total Investments, at fair value	239,913	328,050	554,181	1,039,120	97,205	2,258,469	1,859,496
Security Lending Collateral Invested	<u>46,353</u>	<u>60,889</u>	<u>109,577</u>	<u>203,681</u>	<u>18,377</u>	<u>438,877</u>	<u>565,007</u>
Total Assets	<u>367,028</u>	<u>491,241</u>	<u>882,720</u>	<u>1,652,437</u>	<u>145,722</u>	<u>3,539,148</u>	<u>2,994,889</u>
LIABILITIES							
Accounts Payable	2	1,693	4	1,758	26	3,483	3,897
Securities Lending Collateral Obligations	<u>46,353</u>	<u>60,889</u>	<u>109,577</u>	<u>203,681</u>	<u>18,377</u>	<u>438,877</u>	<u>565,007</u>
Total Liabilities	<u>46,355</u>	<u>62,582</u>	<u>109,581</u>	<u>205,439</u>	<u>18,403</u>	<u>442,360</u>	<u>568,904</u>
Plan Net Assets Held in Trust for							
Insurance Benefits	<u>\$ 320,673</u>	<u>\$ 428,659</u>	<u>\$ 773,139</u>	<u>\$ 1,446,998</u>	<u>\$ 127,319</u>	<u>\$ 3,096,788</u>	<u>\$ 2,425,985</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, 2011 (with Comparative Totals For the Fiscal Year Ended June 30, 2010)

(Dollars in Thousands)

	2011					2010	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
ADDITIONS							
Employers' Contributions	\$ 18,826	\$ 123,256	\$ 98,203	\$ 185,639	\$ 10,051	\$ 435,975	\$ 371,885
Employer Group Waiver Plan	365	10,025	972	10,449	318	22,129	19,794
Premiums Received from Retirees	329	13,235	317	17,060	18	30,959	29,131
Retired Reemployed Healthcare (HB1)	<u>259</u>	<u>2,591</u>	<u>199</u>	<u>993</u>	<u>-</u>	<u>4,042</u>	<u>2,032</u>
Total Contributions	19,779	149,107	99,691	214,141	10,387	493,105	422,842
INVESTMENT INCOME							
From Investing Activities:							
Net Appreciation in							
Fair Value of Investments	40,316	69,615	129,003	255,384	22,724	517,042	274,316
Interest/Dividends	<u>5,729</u>	<u>9,092</u>	<u>12,501</u>	<u>21,577</u>	<u>2,909</u>	<u>51,808</u>	<u>41,076</u>
Total Investing Activities Income	46,045	78,707	141,504	276,961	25,633	568,850	315,392
Investment Expense	843	1,385	2,329	2,347	848	7,752	5,365
Commissions	<u>137</u>	<u>280</u>	<u>265</u>	<u>487</u>	<u>67</u>	<u>1,236</u>	<u>1,200</u>
Total Investing Activities Expense	<u>980</u>	<u>1,665</u>	<u>2,594</u>	<u>2,834</u>	<u>915</u>	<u>8,988</u>	<u>6,565</u>
Net Income from Investing Activities	<u>45,065</u>	<u>77,042</u>	<u>138,910</u>	<u>274,127</u>	<u>24,718</u>	<u>559,862</u>	<u>308,827</u>
From Securities Lending Activities:							
Securities Lending Income	199	261	473	879	79	1,891	1,622
Securities Lending Expense:							
Security Borrower Rebates	25	33	60	112	10	240	71
Security Lending Agent Fees	<u>34</u>	<u>45</u>	<u>81</u>	<u>151</u>	<u>14</u>	<u>325</u>	<u>306</u>
Net Income from Securities Lending Activities	<u>140</u>	<u>183</u>	<u>332</u>	<u>616</u>	<u>55</u>	<u>1,326</u>	<u>1,245</u>
Total Net Investment Income	<u>45,205</u>	<u>77,225</u>	<u>139,242</u>	<u>274,743</u>	<u>24,773</u>	<u>561,188</u>	<u>310,072</u>
Total Additions	64,984	226,332	238,933	488,884	35,160	1,054,293	732,914

KENTUCKY RETIREMENT SYSTEMS

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

For the Fiscal Year Ended June 30, 2011 (with Comparative Totals For the Fiscal Year Ended June 30, 2010)

(Dollars in Thousands)

	2011					2010	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
DEDUCTIONS							
Healthcare Premiums Subsidies	12,723	101,785	46,180	71,859	10,271	242,818	223,356
Administrative Fees	223	4,667	580	4,763	179	10,412	9,703
Self Funding Insurance Costs	2,604	60,019	5,651	60,085	1,901	130,260	130,142
Total Deductions	<u>15,550</u>	<u>166,471</u>	<u>52,411</u>	<u>136,707</u>	<u>12,351</u>	<u>383,490</u>	<u>363,201</u>
Net Increase in Plan Assets	49,434	59,861	186,522	352,177	22,809	670,803	369,713
Plan Net Assets Held in Trust for Insurance Benefits							
Beginning of Year	271,239	368,798	586,617	1,094,821	104,510	2,425,985	2,056,272
End of Year	<u>\$ 320,673</u>	<u>\$ 428,659</u>	<u>\$ 773,139</u>	<u>\$ 1,446,998</u>	<u>\$ 127,319</u>	<u>\$ 3,096,788</u>	<u>\$ 2,425,985</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 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 KRS: (1) KERS; (2) CERS; and (3) SPRS. The assets of the insurance fund are commingled for investment purposes. The following notes apply to the various funds administered by KRS:

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 fiscal years ended June 30, 2011 and 2010 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 fiscal years ended June 30, 2011 and 2010 was \$3,000 (see Note K for further information).

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.

KERS was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 61.515. CERS was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 78.520. 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 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 Pronouncements

In November 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 61, "The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34". The objective of this statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, "The Financial Reporting Entity", and the related financial reporting requirements of Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. KRS is currently evaluating the provisions of GASB No. 61.

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

Membership in each Retirement Plan consisted of the following at June 30, 2011 and 2010:

KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	2011			2010		
	Non- Hazardous Position <u>Employees</u>	Hazardous Position <u>Employees</u>	<u>Total</u>	Non- Hazardous Position <u>Employees</u>	Hazardous Position <u>Employees</u>	<u>Total</u>
Retirees and Beneficiaries						
Receiving Benefits	38,597	3,064	41,661	37,945	2,835	40,780
Inactive Vested Memberships	38,597	3,264	41,861	37,681	3,155	40,836
Active Plan Members	46,617	4,291	50,908	47,090	4,291	51,381
Total	123,811	10,619	134,430	122,716	10,281	132,997
Number of Participating Employers			372			372

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

COUNTY EMPLOYEES RETIREMENT SYSTEM

<u>Number of Members</u>	2011			2010		
	Non- Hazardous Position <u>Employees</u>	Hazardous Position <u>Employees</u>	<u>Total</u>	Non- Hazardous Position <u>Employees</u>	Hazardous Position <u>Employees</u>	<u>Total</u>
Retirees and Beneficiaries						
Receiving Benefits	43,211	6,468	49,679	41,038	6,068	47,106
Inactive Vested Memberships	65,914	2,774	68,688	64,004	2,631	66,635
Active Plan Members	85,285	9,407	94,692	84,681	9,562	94,243
Total	194,410	18,649	213,059	189,723	18,261	207,984
Number of Participating Employers			1,396			1,396

STATE POLICE RETIREMENT SYSTEM

<u>Number of Members</u>	2011	2010
	Hazardous Position <u>Employees</u>	Hazardous Position <u>Employees</u>
Retirees and Beneficiaries Receiving Benefits	1,263	1,223
Inactive Vested Memberships	357	345
Active Plan Members	965	961
Total	2,585	2,529
Number of Participating Employers	1	1

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND

Hospital and Medical Contracts consisted of the following at June 30, 2011 and 2010:

	2011					2010				
	Single	Couple/ Family	Parent	Medicare Without Prescription	Medicare With Prescription	Single	Couple/ Family	Parent	Medicare Without Prescription	Medicare With Prescription
KERS Non-Hazardous	10,321	2,155	732	1,821	13,988	10,420	1,971	722	1,831	13,765
KERS Hazardous	615	21	75	60	570	599	453	66	63	525
CERS Non-Hazardous	8,013	1,552	351	3,167	15,100	7,692	1,369	342	3,106	14,477
CERS Hazardous	1,310	2,156	253	58	1,527	1,274	2,062	239	58	1,438
SPRS	278	474	52	14	499	264	462	47	12	467
Totals	<u>20,537</u>	<u>6,358</u>	<u>1,463</u>	<u>5,120</u>	<u>31,684</u>	<u>20,249</u>	<u>6,317</u>	<u>1,416</u>	<u>5,070</u>	<u>30,672</u>

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. Prior to July 1, 2009, cost-of-living adjustments (COLA) were 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, 2011 and 2010, 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, 2011 and 2010, participating employers contributed 16.98% and 11.61%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2011 and 2010, were 38.58% and 39.45%, 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. Prior to July 1, 2009, cost-of-living adjustments (COLA) were 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, 2011 and 2010, 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, 2011 and 2010, participating employers contributed 26.12% and 24.69%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2011 and 2010, were 34.37% and 35.54%, 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. Prior to July 1, 2009, cost-of-living adjustments (COLA) were 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, 2011 and 2010, 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, 2011 and 2010, participating employers contributed 16.93% and 16.16%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2011 and 2010, were 16.93% and 20.91%, 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 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. Prior to July 1, 2009, cost-of-living adjustments (COLA) were 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, 2011 and 2010, 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, 2011 and 2010, participating employers contributed 33.25% and 32.97%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2011 and 2010, were 33.25% and 43.36%, 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. Prior to July 1, 2009, cost-of-living adjustments (COLA) were 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, 2011 and 2010, 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, 2011 and 2010, the Commonwealth contributed 45.54% and 33.08%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2011 and 2010 were 85.63% and 92.12%, 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, 2011, insurance premiums withheld from benefit payments for members of the systems were \$29,350,195 and \$1,225,236 for KERS non-hazardous and hazardous, respectively; \$29,219,273 and \$2,017,208 for CERS non-hazardous and hazardous, respectively; and, \$250,282 for SPRS. For fiscal 2010, insurance premiums withheld from benefit payments for members of KERS were \$29,181,932 and \$1,665,204 for KERS non-hazardous and KERS hazardous, respectively; \$29,677,911 and \$1,804,656 for CERS non-hazardous and CERS hazardous, respectively; and, \$234,577 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, 2011, the Fund had 92,989 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 of its self-insured program directly from its insurance assets.

KRS selected Catalyst Rx 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

	<u>2011</u>	<u>2010</u>
Cash	\$ 1,197,306	\$ 901,440
Short-Term Investments	387,987,312	193,075,338
Securities Lending Collateral Invested	<u>596,906,253</u>	<u>847,326,415</u>
Total	<u>\$ 986,090,871</u>	<u>\$ 1,041,303,193</u>

COUNTY EMPLOYEES RETIREMENT SYSTEM

	<u>2011</u>	<u>2010</u>
Cash	\$ 1,250,932	\$ 984,279
Short-Term Investments	892,898,087	388,391,558
Securities Lending Collateral Invested	<u>1,082,381,468</u>	<u>1,355,857,873</u>
Total	<u>\$ 1,976,530,487</u>	<u>\$ 1,745,233,710</u>

STATE POLICE RETIREMENT SYSTEM

	<u>2011</u>	<u>2010</u>
Cash	\$ 292,029	\$ 149,615
Short-Term Investments	28,452,304	19,635,485
Securities Lending Collateral Invested	<u>41,306,830</u>	<u>56,955,523</u>
Total	<u>\$ 70,051,163</u>	<u>\$ 76,740,623</u>

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>2011</u>	<u>2010</u>
Cash	\$ 2,015,579	\$ 1,029,033
Short-Term Investments	758,893,370	535,639,023
Medicare Drug Deposit	100,620	100,446
Securities Lending Collateral Invested	<u>438,877,452</u>	<u>565,007,164</u>
Total	<u>\$ 1,199,887,021</u>	<u>\$ 1,101,775,666</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.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Mortgages - Investment may be made in real estate mortgages on a direct basis or in the form of mortgage pool instruments.

Private Equity/Equity Real Estate/Real Return/Absolute Return Investments - 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, but not limited to and without limitation, venture capital, private equity, private placements, real assets and absolute return investments 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, variable rate demand notes, government and agency bonds, mortgages and collective STIF's, money market funds or instruments (including, but not limited to , certificates of deposit, bank notes, deposit notes, bankers' acceptances and commercial paper) and repurchase agreements (relating to the above instruments). Instruments may be selected from among those having an investment grade rating at the time of purchase by at least one recognized bond rating service. In cases where the instrument has a split rating, the lower of the two ratings shall prevail. 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. Variable rate securities shall be deemed to have a maturity equal to the time left until the next interest rate reset occurs, but in no case will any security have a stated final maturity of more than three years.

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, unless specifically allowed by a manager's contract.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

In conjunction with the adoption of Governmental Accounting Standards Board (GASB) Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments", KRS provides this additional disclosure regarding its derivatives:

Background Information

As of June 30, 2011, KRS has the following derivative instruments outstanding:

<u>Item</u>	<u>Type</u>	<u>Objective</u>	<u>Cost</u>	<u>Notional Cost</u>	<u>Market Value</u>	<u>Terms</u>	<u>Notional Market Value</u>
Pension:							
A	Equity Contracts	Substitute for common stock	\$460,878	\$0	\$68,921	Various	\$868,796,035
B	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	\$0	\$0	(\$29,317,818)	Various	\$0
C	Interest Rate Contracts	Hedge against the risk that interest rates will move in an adverse direction	\$0	\$367,665,325	\$0	Various	\$368,603,638
D	SWAPs	Hedge against sudden or dramatic shifts in interest rates	(\$677,925)	\$0	(\$1,982,285)	Various	\$0
Insurance:							
E	Equity Contracts	Substitute for common stock	\$0	\$0	\$0	Various	\$527,274,305
F	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	\$0	\$0	(\$11,307,268)	Various	\$0

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

G	Interest Rate Contracts	Hedge against the risk that interest rates will move in an adverse direction	\$0	\$33,530,613	\$0	Various	\$0
H	SWAPs	Hedge against sudden or dramatic shifts in interest rates	\$100,634	\$0	\$296,233	Various	\$33,584,200

All of the above have various Effective Dates and Maturity Dates.

It is the policy of KRS that investment managers may invest in derivative securities, or strategies which make use of derivative investments, only if such investments do not cause the portfolio to be in any way leveraged beyond a 100% invested position. Examples of such derivatives include, but are not limited to, foreign currency forward contracts, collateralized mortgage obligations, treasury inflation protected securities, futures, options and swaps.

Investments in derivative securities which are subject to large or unanticipated changes in duration or cash flows, such as interest only, principal only, inverse floater, or structured note securities are permitted only to the extent authorized in an alternative investment offering memorandum or agreement.

Investments in securities such as collateralized mortgage obligations and planned amortization class issues are allowed if, in the judgment of the investment manager, they are not expected to be subject to large or unanticipated changes in duration or cash flows. Investment managers may make use of derivative securities for defensive or hedging purposes. Any derivative security shall be sufficiently liquid that it can be expected to be sold at, or near, its most recently quoted market price.

Derivative instruments A and E are substitutes for common stock with an investment that is recorded at fair value.

Derivative instruments B and F hedge against the decrease of non US dollar currencies.

For accounting and financial reporting purposes, all derivative instruments are considered investment derivative instruments. The derivatives have been segregated on the Combined Statement of Plan Net Assets for both Pension and Insurance.

Risks:

Basis Risk: Derivative instruments A and E expose KRS to basis risk in that the value of the underlying equity index future may decrease in fair value relative to the cash market. Derivative instruments B and F expose KRS to basis risk in that the value of the foreign currency futures or forwards may decrease in fair value relative to the cash market.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Interest Rate Risk: Derivative instruments C, D, G, and H expose KRS to interest rate risk in that changes in interest rates will adversely affect the fair values of KRS' financial instruments.

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). In 2010, the US Congress passed the Financial Crisis Bill and permanently increased the FDIC deposit insurance coverage to \$250,000. 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.

As of June 30, 2011 and 2010, deposits for KRS pension funds were \$4,795,307 and \$5,481,332, respectively. None of these balances were exposed to custodial credit risk as they were either insured or collateralized at required levels.

As of June 30, 2011 and 2010, deposits for KRS insurance fund were \$2,020,499 and \$1,023,289, 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. As of June 30, 2011 and 2010, the following currencies were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in KRS' name. These funds are cash held by KRS' Global Managers and consist of various currencies.

Pension Funds	<u>2011</u>	<u>2010</u>
Foreign Currency	\$ 8,971,696	\$ 9,439,108
Insurance Fund		
Foreign Currency	\$ 3,703,274	\$ 3,106,813

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* contains the specific guidelines for the investment of pension and 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, 2011 and 2010:

	2011	2010
Pension Funds		
US Gov't & Agency Fixed Income Securities	\$ 2,474,974,219	\$ 2,585,430,034
US Corporate Fixed Income Securities	1,063,223,703	689,815,783
Municipal Debt Securities	78,975,354	57,330,669
Short-Term Investments	1,677,941,341	601,104,211
Equity Securities	5,994,749,969	4,931,386,776
Private Equity Limited Partnerships	1,392,099,971	1,547,888,010
Real Estate	32,251,271	15,075,788
Other*	(1,220,227,180)	(59,897)
	\$ 11,493,988,648	\$ 10,427,971,374

* As of June 30, 2011, this balance consists of:

Cash Collateral – US Dollars		\$ 2,570,028
Sukuk		94,750
Real Estate		16,500,000
Derivative Offsets:		
US Dollars	(368,603,638)	
Equity Futures	(868,796,035)	(1,237,399,673)
Liabilities:		
Obligation to Return Cash		
Collateral - US Dollars		(1,992,285)
		\$ (1,220,227,180)

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

	2011	2010
Insurance Fund		
US Gov't & Agency Fixed Income Securities	\$ 537,586,644	\$ 276,626,088
US Corporate Fixed Income Securities	154,320,004	
Municipal Debt Securities	14,331,627	
Short-Term Investments	792,578,190	535,739,469
Equity Securities	1,847,247,012	1,385,112,612
Private Equity Limited Partnerships	225,938,724	197,141,097
Real Estate	2,522,855	614,468
Other**	(557,062,260)	
	\$ 3,017,462,796	\$ 2,395,233,734

** As of June 30, 2011, this balance consists of:

Cash Collateral – US Dollars		\$ 328,313
Real Estate		3,500,000
Derivative Offsets:		
US Dollars	(33,584,200)	
Equity Futures	(527,274,305)	(560,858,505)
Liabilities:		
Swaps - US Dollars		(32,068)
		\$ (557,062,260)

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 KRS Fixed Income by more than 25%.
- The duration of the TIPS portfolio shall not deviate from the KRS Fixed Income Index by more than 25%.
- 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 15% 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 funds debt ratings as of June 30, 2011 and 2010:

Pension Funds		
Debt Securities Investments at Fair Value		
As of June 30, 2011 and 2010		
<u>Quality Rating</u>	<u>2011</u>	<u>2010</u>
AAA	\$ 91,317,082	\$ 1,863,001,127
AA+	34,390,755	48,288,094
AA	39,864,586	30,226,149
AA-	50,219,759	46,648,330
A+	104,187,245	59,293,411
A	146,999,473	156,019,707
A-	152,567,548	72,715,716
BBB+	64,799,988	59,200,990
BBB	112,518,837	
BBB-	56,358,144	144,675,132
BB+	7,166,376	2,206,904
BB	13,417,689	10,978,677
BB-	28,485,658	2,475,945
B+	27,997,068	4,457,839
B	21,129,569	
B-	32,172,492	15,903,098
CCC+	6,138,146	
CCC	8,838,429	2,836,252
CCC-	1,590,633	
CC		1,843,910
D	3,394,737	
NR	138,644,843	70,462,745
Total Credit Risk Debt Securities	<u>1,142,199,057</u>	<u>2,591,234,026</u>
Government Bonds	508,207,024	115,820,255
Government Mortgage-Backed Securities (GNMA)	725,318,403	575,722,459
Gov't Issued Commercial Mortgage Backed	6,325,040	4,631,391
Government Agencies	95,545,823	6,265,527
Indexed Linked Bonds	1,139,577,929	38,894,681
Total Debt Securities	<u>\$ 3,617,173,276</u>	<u>\$ 3,332,568,339</u>

At both June 30, 2011 and 2010, the weighted average quality rating of the pension fund debt securities portfolio was AA+. As of June 30, 2011 and 2010, the KRS pension portfolio had \$150,330,797 and \$40,702,625, respectively, in debt securities rated below BBB-. The fair value of securities in the BBB- rating category was \$56,358,144 and \$144,675,132, respectively, as of June 30, 2011 and 2010.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

The following tables present the KRS insurance fund debt ratings as of June 30, 2011 and 2010:

Insurance Fund		
Debt Securities Investments at Fair Value		
As of June 30, 2011 and 2010		
Quality Rating	2011	2010
AAA	\$ 43,946,738	\$
AA+	2,359,902	
AA	7,044,017	
AA-	7,138,193	
A+	20,243,053	
A	18,381,398	
A-	21,875,607	
BBB+	7,975,298	
BBB	15,146,772	
BBB-	7,256,147	
BB+	202,742	
BB	1,156,866	
BB-	1,916,666	
B+	3,169,797	
B	2,226,250	
CCC+	259,375	
NR	8,352,810	
Total Credit Risk Debt Securities	168,651,631	
Government Bonds	94,082,811	
Government Mortgage-Backed Securities (GNMA)	114,153,699	
Gov't Issued Commercial Mortgage Backed	761,681	
Government Agencies	13,394,544	
Indexed Linked Bonds	315,193,909	276,626,088
Total Debt Securities	\$ 706,238,275	\$ 276,626,088

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

As a result of the most recently approved Asset/Liability Modeling Study, the investment staff began to diversify the insurance fixed income allocation to mirror that of the pension funds. As part of this process, the TIPS allocation (previously the only fixed income exposure within the insurance portfolio) was moved to the newly created Real Return Asset Class.

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% of the total portfolio at market value.

As of June 30, 2011, the Pension Funds held \$847,510,267, or 8.3%, and the Insurance Fund held \$184,842,522, or 8.2%, of its investments in Exchange Traded Funds (ETF's). 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.

As of June 30, 2011, the Pension Fund held \$457,059,745, or 4.5%, of its investment in the Federal National Mortgage Association (Fannie Mae). 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.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

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 KRS pension fund benchmarks its debt securities portfolio to a weighted average benchmark consisting of the Barclays Capital Aggregate Index and the Barclays Capital US TIPS Index. As of June 30, 2011 and 2010, the effective duration of the benchmark was 6.03 and 5.35, respectively. At the same points in time, the effective duration of the KRS pension fund debt securities portfolio was 3.83 and 4.57, respectively.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

KRS Pension Funds Interest Rate Risk

	2011	Weighted Average Effective Duration	2010	Weighted Average Effective Duration
Asset Backed Securities	\$ 86,628,031	0.64	\$ 80,459,816	0.93
Bank Loans	41,962,680	0.35		
Collateralized Bonds	6,325,040	(0.22)		
Commercial Mortgage				
Backed Securities	88,520,168	4.68	78,536,394	4.68
Corporate Bonds	735,281,195	4.78	513,442,002	5.53
Government Agencies	93,545,823	3.97	68,928,647	4.85
Government Bonds	508,207,024	4.73	915,274,910	5.40
Government Mortgage				
Backed Securities	707,971,763	2.91	576,152,433	2.18
Government Issued				
Commercial Mortgage				
Backed Securities	5,211,936	3.22	4,631,391	3.31
Guaranteed Fixed Income	18,882,082	1.37	45,610,184	2.01
Indexed Linked				
Government Bonds	1,139,577,929	3.68	967,658,299	4.95
Municipal Bonds	78,975,354	10.54	57,330,669	11.36
Non-Government Backed				
Collateralized Mortgage				
Obligations	15,576,827	1.83	17,369,425	1.45
Other Fixed Income			7,174,169	0.38
Short Term Bills/Notes	90,412,674	0.38		
Sukuk	94,750	0.09	-	-
Total	\$ 3,617,173,276	3.83	\$ 3,332,568,339	4.57

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

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 a weighted average benchmark consisting of the Barclays Capital Aggregate Index and the Barclays Capital US TIPS Index (beginning in April 2011).the Barclays Capital US TIPS Index. At June 30, 2011 and 2010, (the previous benchmark), the modified duration of the benchmark was 7.14 and 5.26, respectively. At the same points in time, the modified duration of the KRS insurance fund debt securities portfolio, excluding the pooled fund, was 5.83 and 7.12, respectively.

KRS Insurance Fund Interest Rate Risk

	2011	Weighted Average Effective Duration	2010	Weighted Average Effective Duration
Asset Backed Securities	\$ 1,000,340	1.73	\$	
Bank Loans	5,808,008	3.58		
Commercial Mortgage Backed Securities	11,977,676	4.42		
Corporate Bonds	69,145,598	5.78		
Government Agencies	13,394,544	4.34		
Government Bonds	94,082,811	4.79		
Government Mortgage Backed Securities	114,153,699	4.19		
Government Issued Commercial Mortgage Backed Securities	534,001	3.51		
Guaranteed Fixed Income	4,439,819	1.85		
Indexed Linked Government Bonds	315,193,909	7.78	276,626,088	8.24
Municipal/Provincial Bonds	14,331,627	10.74		
Non-Government Backed Collateralized Mortgage Obligations	2,293,809	3.47		
Short Term Bills/Notes	59,882,434	0.39		
Total	\$ 706,238,275	5.83	\$ 276,626,088	8.24

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 value of a non-US dollar based investment or deposit with the KRS portfolio. KRS' currency risk exposure, or exchange rate risk, primarily resides with KRS' international equity holdings, but also affects other asset classes. KRS does not have a formal policy to limit foreign currency risk, however, KRS employs a third party vendor to hedge major currency exposures, as described below.

All foreign currency transactions are classified as Short-Term Investments. All gains and losses associated with these transactions are recorded in the *Net Appreciation (Depreciation) in the Fair Value of Investments* on the financial statements.

KRS transferred \$12,043,264 of the Pension Funds, and \$4,197,722 of the Insurance Fund, to the Record Currency Management Program (RCM), a total of \$16,243,160. The RCM program began in September 2009. The RCM account experienced a tremendous amount of growth through May 2011 when it peaked with a market value of \$82,001,355 in the Pension Funds, and \$30,026,900 in the Insurance Fund, a total of \$112,028,255. It began to lose ground in June 2011, which led to a loss of \$6,752,497 in the Pension Funds, and \$3,516,224 in the Insurance Fund, for a total overall RCM loss of \$10,268,721 in fiscal 2011.

KRS employs a currency manager to hedge some exchange rate risk by utilizing a trend following strategy which increases or decreases the currency hedge ratio as risk increases or decreases. The following tables present KRS' exposure to foreign currency risk as of June 30, 2011 and 2010:

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

	Pension Funds	
	Investments at Fair Value	
	June 30, 2011 and 2010	
	2011	2010
Foreign Equities		
Argentine Peso	\$ 1,196,140	
Australian Dollar	94,694,698	\$ 25,036,391
Brazilian Real	4,278,639	2,694,860
British Pound Sterling	134,777,442	16,602,057
Canadian Dollar	134,071,078	114,533,022
Chinese Yuan	521,787	
Columbian Peso	1,222,930	
Czech Koruna	1,658,886	157,720
Danish Krone	16,152,506	10,286,579
Euro	433,029,933	(30,181,148)
Hong Kong Dollar	68,788,630	37,363,932
Hungarian Forint		221,870
Indonesian Rupiah	2,243,714	303,437
Japanese Yen	265,405,175	277,826,132
Malaysian Ringgit	2,426,541	387,001
Mexican Peso	3,661,558	835,982
New Taiwan Dollar	5,254,844	7,634,477
New Zealand Dollar	1,338,143	
Norwegian Krone	11,346,709	8,531,898
Philippine Peso	138,885	
Polish Zloty		1,761,559
Russian Ruble	1,036,961	
Singapore Dollar	22,053,536	22,180,537
South African Rand	2,758,884	3,216,614
South Korean Won	4,512,110	2,920,668
Swedish Krona	23,544,658	2,732,084
Swiss Franc	95,068,382	21,699,339
International Equity Mutual Fund (various currencies)	920,141,284	795,533,850
Total Securities subject to Foreign Currency Risk	2,251,324,053	1,322,278,861
USD (securities held by International Investment Managers)	1,659,713,681	840,612,985
Total International Investment Securities	\$ 3,911,037,734	\$ 2,162,891,846

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Insurance Fund		
Investments at Fair Value		
June 30, 2011 and 2010		
	2011	2010
Foreign Equities		
Australian Dollar	\$ 37,342,712	\$ 9,589,648
Brazilian Real	607,112	1,003,876
British Pound Sterling	50,278,435	8,051,772
Canadian Dollar	53,058,136	43,845,544
Czech Koruna	427,698	67,148
Danish Krone	5,937,869	4,042,009
Euro	167,585,939	(7,500,903)
Hong Kong Dollar	24,192,383	13,824,640
Hungarian Forint	71	75,604
Indonesian Rupiah	2,832	105,386
Japanese Yen	104,116,859	104,237,243
Malaysian Ringgit		29,102
Mexican Peso	370,341	278,282
New Taiwan Dollar	1,351,967	2,302,510
New Zealand Dollar	556,742	
Norwegian Krone	4,589,032	3,174,376
Polish Zloty		684,280
Singapore Dollar	8,739,442	8,164,651
South African Rand	307,167	1,145,561
South Korean Won	1,165,059	980,970
Swedish Krona	8,758,300	1,109,872
Swiss Franc	36,824,057	8,941,929
International Equity Mutual Fund (various currencies)	199,878,520	101,560,347
Total Securities subject to Foreign Currency Risk	706,090,673	305,713,847
USD (securities held by International Investment Managers)	524,261,020	310,656,636
Total International Investment Securities	\$ 1,230,351,693	\$ 616,370,483

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* does not address any restrictions on the amount of loans that can be made. At June 30, 2011, 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. The custodial bank invests cash collateral in the agent's short-term investment pool as permitted by state statute and Board policy. The custodian of the Funds cannot pledge or sell collateral securities received unless the borrower defaults.

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.

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.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE F-RISKS OF LOSS, CONTINUED

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 \$200,000. Defense costs incurred in defending such claims will be paid by the insurance company. However, the total defense cost and claims paid shall not exceed the total aggregate coverage of the policy.

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

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, generally, not subject to tax. KRS continues to be subject to income tax on its unrelated business income.

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, 2011, 2010, and 2009. KRS contributed 16.98%, 11.61%, and 10.01% of covered payroll for the periods ended June 30, 2011, 2010, and 2009, respectively.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE I-DEFINED BENEFIT PENSION PLAN, CONTINUED

The chart below includes the covered payroll and contribution amounts for KRS for the three periods included in this discussion.

	2011	2010	2009
Covered Payroll	\$ 13,444,315	\$ 13,383,859	\$ 12,864,700
Required Employer Contributions	2,282,864	1,553,865	1,287,800
Employer Percentage Contributed	100%	100%	100%

NOTE J-EQUIPMENT

Equipment consists of the following:

	June 30	
	2011	2010
Equipment, at cost	\$ 6,971,185	\$ 6,795,760
Less Accumulated Depreciation	<u>(2,987,098)</u>	<u>(2,924,895)</u>
	<u>\$ 3,984,087</u>	<u>\$ 3,870,865</u>

Depreciation expense for the fiscal years ended June 30, 2011 and 2010 amounted to \$62,203 and \$215,200, respectively. In fiscal 2010, several fixed assets were fully depreciated (this amount totaled \$988,347), therefore, depreciation expense decreased from the prior fiscal year.

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	
	2011	2010
Software, at cost	\$ 7,424,611	\$ 6,478,561
Less Accumulated Amortization	<u>(1,682,261)</u>	<u>(993,788)</u>
	<u>\$ 5,742,350</u>	<u>\$ 5,484,773</u>

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE K-INTANGIBLE ASSETS, CONTINUED

Amortization expense for the fiscal years ended June 30, 2011 and 2010 amounted to \$688,473 and \$647,857, respectively.

In fiscal 2007, KRS initiated the START project. It is anticipated that START will be completed in its entirety in fiscal 2013. 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.

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 was 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.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE L-ALTERNATIVE INVESTMENTS, CONTINUED

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 Forrester 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 was accrued as a receivable as of 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 \$52,503.

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 recommendations 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, 2011	June 30, 2011
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	26 Years	26 Years
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market
Actuarial Assumptions:		
Investment Return*	7.75%	7.75%
<i>*Includes Price Inflation at</i>	3.5%	3.5%
Projected Salary Increases**	4.75%-13.0%	4.5%-20.0%
Cost of Living Adjustment	None	None
<i>**Includes Wage Inflation at</i>	4.5%	4.5%

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE M-ACTUARIAL VALUATION, CONTINUED

INSURANCE FUND***

	Non-Hazardous	Hazardous
Valuation Date	June 30, 2011	June 30, 2011
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	26 Years	26 Years
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market
Medical Trend Assumption (Pre-Medicare)	10.5%-5.0%	10.5%-5.0%
Medical Trend Assumption (Post-Medicare)	8.5%-5.0%	8.5%-5.0%
Year of Ultimate Trend	2019	2019
Actuarial Assumptions:		
Investment Rate of Return*	7.75%**	7.75%
<i>*Includes Price Inflation at</i>	3.5%	3.5%

**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.

***The actuarial valuation for the Insurance Fund involves estimates of the value of reported amounts and assumptions about the probability of future events. Actuarially determined amounts are subject to continual revision as results are compared to past expectations and new estimates are made about the future. Calculations are based on the benefits provided under the terms of the insurance plan in effect at the time of each valuation and on the pattern of sharing costs between the employer and plan members as of the valuation date. Actuarial calculations of the insurance plan reflect a long-term perspective.

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 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Pension Funds:		
Kentucky Employees Retirement System (Non-Hazardous)	\$ 7,455,155,945	\$ 6,794,579,504
Kentucky Employees Retirement System (Hazardous)	210,544,939	185,420,442
County Employees Retirement System (Non-Hazardous)	3,288,473,842	2,912,164,989
County Employees Retirement System (Hazardous)	1,079,495,659	922,687,519
State Police Retirement System	<u>348,798,770</u>	<u>307,867,514</u>
Total Pension Funds	<u>12,382,469,155</u>	<u>11,122,719,968</u>
 Insurance Fund:		
Kentucky Employees Retirement System (Non-Hazardous)	3,828,469,191	3,994,794,413
Kentucky Employees Retirement System (Hazardous)	177,097,152	178,870,233
County Employees Retirement System (Non-Hazardous)	1,640,522,412	1,865,301,581
County Employees Retirement System (Hazardous)	876,912,481	981,933,446
State Police Retirement System	<u>314,740,474</u>	<u>313,785,412</u>
Total Insurance Fund	<u>6,837,741,710</u>	<u>7,334,685,085</u>
 Total Unfunded Actuarial Accrued Liability	 <u>\$ 19,220,210,865</u>	 <u>\$ 18,457,405,053</u>

KENTUCKY RETIREMENT SYSTEMS

Notes to the Financial Statements, continued

NOTE M-ACTUARIAL VALUATION, CONTINUED

The following is the Schedule of Funding Progress for the fiscal year ended June 30, 2011:

	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL) Entry Age Normal</u>	<u>Percent Funded</u>	<u>Covered Payroll</u>	<u>Unfunded AAL as a % of Covered Payroll</u>
Pension Funds:					
Kentucky Employees Retirement System (Non-Hazardous)	\$ 3,726,986,087	\$ 11,182,142,032	33.3	\$ 1,731,632,748	430.5
Kentucky Employees Retirement System (Hazardous)	510,748,505	721,293,444	70.8	133,053,792	158.2
County Employees Retirement System (Non-Hazardous)	5,629,611,183	8,918,085,025	63.1	2,276,595,948	144.4
County Employees Retirement System (Hazardous)	1,779,545,393	2,859,041,052	62.2	466,963,860	231.2
State Police Retirement System	<u>285,580,631</u>	<u>634,379,401</u>	<u>45.0</u>	<u>48,692,616</u>	<u>716.3</u>
Total Pension Funds	<u>11,932,471,799</u>	<u>24,314,940,954</u>	<u>49.1</u>	<u>4,656,938,964</u>	<u>265.9</u>
Insurance Fund:					
Kentucky Employees Retirement System (Non-Hazardous)	451,620,442	4,280,089,633	10.6	1,731,632,748	221.1
Kentucky Employees Retirement System (Hazardous)	329,961,615	507,058,767	65.1	133,053,792	133.1
County Employees Retirement System (Non-Hazardous)	1,433,450,793	3,073,973,205	46.6	2,276,595,948	72.1
County Employees Retirement System (Hazardous)	770,790,274	1,647,702,755	46.8	466,963,860	187.8
State Police Retirement System	<u>123,687,289</u>	<u>438,427,763</u>	<u>28.2</u>	<u>48,692,616</u>	<u>646.4</u>
Total Insurance Fund	<u>3,109,510,413</u>	<u>9,947,252,123</u>	<u>31.3</u>	<u>4,656,938,964</u>	<u>146.8</u>
Totals	<u>\$ 15,041,982,212</u>	<u>\$ 34,262,193,077</u>	<u>43.9</u>	<u>\$ 9,313,877,928</u>	<u>206.4</u>

The Schedule of Funding Progress for the Pension Funds is on pages 59 through 61. The Schedule of Funding Progress for the Insurance Fund is on pages 62 through 64.

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 2011 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 2011 were enacted by House Bill 1 in the 2008 Special Legislative Session. The Employer contribution rates were established as follows (effective July 1, 2010):

KERS-Non Hazardous	16.98%
KERS-Hazardous	26.12%
CERS-Non Hazardous	16.93%
CERS-Hazardous	33.25%
SPRS	45.54%

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 Option 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 (Northern Trust). As of June 30, 2011 and 2010, the Insolvency Account amounted to \$100,620 and \$100,446, respectively.

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. As of June 30, 2011 and 2010, the reimbursement totaled \$4,041,974 and \$2,032,659, respectively.

NOTE Q-LOUISVILLE/JEFFERSON COUNTY METRO FIREFIGHTERS

Firefighter employees of Louisville/Jefferson County Metro Government were awarded a total of \$28,440,159 for back-pay. Of that total, \$28,425,232, was determined to be the amount of creditable compensation. The total contributions owed to KRS were calculated by applying the contribution rate in effect for each fiscal year awarded (fiscal 1986 to fiscal 2009) while considering the appropriate participation status, hazardous or non-hazardous, of each employee. These calculations established that the total employer contribution owed is \$5,113,511, and the total employee contribution owed is \$2,083,310, for a total of \$7,196,821. This amount was received on July 27, 2010.

KRS also calculated the impact of the increased final compensation caused by the retroactive benefits owed to those firefighters who have already initiated their retirement benefits. KRS will be required to pay retroactive benefit payments totaling \$6,221,219, reflecting additional benefits due to the increase in final compensation. This liability was properly accounted for in fiscal 2011. The liability was paid on August 22, 2010, by issuance of benefit payments to the individual firefighter members.

Kentucky Revised Statute 61.675(3)(b) requires that KRS collect interest on unmade or delinquent contributions. The interest owed by the Metro Government, as calculated by KRS' actuaries, amounted to \$12,020,731. Therefore, the total amount due KRS is \$19,217,552. As stated earlier, \$7,196,821 has been received.

NOTE R-SUBSEQUENT EVENTS

Management has evaluated the period from June 30, 2011, to November 17, 2011, (the date the financial statements were available to be issued) for items requiring recognition or disclosure in the financial statements. There were no events occurring during the evaluation period that require disclosure, and there were no events that require recognition in the financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedule of Funding Progress

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)-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)	UAAL as a % of Covered Payroll [(b-a)/c]
<u>Non-Hazardous</u>						
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
June 30, 2010**	4,210,215,585	11,004,795,089	6,794,579,504	38.3	1,815,146,388	374.3
June 30, 2011**	3,726,986,087	11,182,142,032	7,455,155,945	33.3	1,731,632,748	430.5
<u>Hazardous</u>						
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
June 30, 2010**	502,729,009	688,149,451	185,420,442	73.1	143,557,944	129.2
June 30, 2011**	510,748,505	721,293,444	210,544,939	70.8	133,053,792	158.2
<u>Total</u>						
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	3,681,411,635	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
June 30, 2010**	4,712,944,594	11,692,944,540	6,979,999,946	40.3	1,958,704,332	356.4
June 30, 2011**	4,237,734,592	11,903,435,476	7,665,700,884	35.6	1,864,686,540	411.1

**Covered payroll was actuarially computed.

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)	UAAL as a % of Covered Payroll [(b-a)/c]
<u>Non-Hazardous</u>						
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
June 30, 2010**	5,546,857,291	8,459,022,280	2,912,164,989	65.6	2,236,855,380	130.2
June 30, 2011**	5,629,611,183	8,918,085,025	3,288,473,842	63.1	2,276,595,948	144.4
<u>Hazardous</u>						
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
June 30, 2010**	1,749,464,388	2,672,151,907	922,687,519	65.5	466,548,660	197.8
June 30, 2011**	1,779,545,393	2,859,041,052	1,079,495,659	62.2	466,963,860	231.2
<u>Total</u>						
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
June 30, 2010**	7,296,321,679	11,131,174,187	3,834,852,508	65.5	2,703,404,040	141.9
June 30, 2011**	7,409,156,576	11,777,126,077	4,367,969,501	62.9	2,743,559,808	159.2

**Covered payroll was actuarially computed.

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, 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
June 30, 2010**	304,577,292	612,444,806	307,867,514	49.7	51,506,712	597.7
June 30, 2011**	285,580,631	634,379,401	348,798,770	45.0	48,692,616	716.3

**Covered payroll was actuarially computed.

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedule of Funding Progress

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)-INSURANCE FUND

	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, 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
June 30, 2010**	471,341,628	4,466,136,041	3,994,794,413	10.6	1,815,146,388	220.1
June 30, 2011**	451,620,442	4,280,089,633	3,828,469,191	10.6	1,731,632,748	221.1
<u>Hazardous:</u>						
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
June 30, 2010**	314,427,296	493,297,529	178,870,233	63.7	143,557,944	124.6
June 30, 2011**	329,961,615	507,058,767	177,097,152	65.1	133,053,792	133.1
<u>Total</u>						
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	1,840,978,097	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
June 30, 2010**	785,768,924	4,959,433,570	4,173,664,646	15.8	1,958,704,332	213.1
June 30, 2011**	781,582,057	4,787,148,400	4,005,566,343	16.3	1,864,686,540	214.8

**Covered payroll was actuarially computed.

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) 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, 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
June 30, 2010**	1,293,038,593	3,158,340,174	1,865,301,581	40.9	2,236,855,380	83.4
June 30, 2011**	1,433,450,793	3,073,973,205	1,640,522,412	46.6	2,276,595,948	72.1
<u>Hazardous</u>						
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
June 30, 2010**	692,769,770	1,674,703,216	981,933,446	41.4	466,548,660	210.5
June 30, 2011**	770,790,274	1,647,702,755	876,912,481	46.8	466,963,860	187.8
<u>Total</u>						
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
June 30, 2010**	1,985,808,363	4,833,043,390	2,847,235,027	41.1	2,703,404,040	105.3
June 30, 2011**	2,204,241,067	4,721,675,960	2,517,434,893	46.7	2,743,559,808	91.8

**Covered payroll was actuarially computed.

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) 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]
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
June 30, 2010**	121,175,083	434,960,495	313,785,412	27.9	51,506,712	609.2
June 30, 2011**	123,687,289	438,427,763	314,740,474	28.2	48,692,616	646.4

**Covered payroll was actuarially computed.

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, 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
June 30, 2010	348,494,678	144,050,560		41.3
June 30, 2011	381,915,236	193,754,471		50.7

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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
June 30, 2010	376,556,187	93,976,917	8,550,914	27.2
June 30, 2011	294,897,813	129,335,552		43.9

Total

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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
June 30, 2010	725,050,865	238,027,477	8,550,914	34.0
June 30, 2011	676,813,049	323,090,023		47.7

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, 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
June 30, 2010	17,814,630	17,658,058		99.1
June 30, 2011	20,605,070	19,140,508		92.9

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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
June 30, 2010	35,045,278	21,921,535	319,059	63.5
June 30, 2011	29,585,257	19,952,580		67.4

Total

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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	75.5
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
June 30, 2010	52,859,908	39,579,593	319,059	75.5
June 30, 2011	50,190,327	39,093,088		77.9

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, 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
June 30, 2010	186,724,383	207,075,842		110.9
June 30, 2011	218,984,628	248,518,574		113.5

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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
June 30, 2010	266,331,326	166,607,097	9,156,991	66.0
June 30, 2011	213,429,424	186,885,576		87.6

Total

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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	73.0
June 30, 2010	453,055,709	373,682,939	9,156,991	84.5
June 30, 2011	432,414,052	435,404,150		100.7

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, 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
June 30, 2010	76,390,669	82,887,128		108.5
June 30, 2011	78,765,602	85,078,181		108.0

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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
June 30, 2010	129,227,449	83,042,875	1,493,440	65.4
June 30, 2011	109,226,667	98,592,286		90.3

Total

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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
June 30, 2010	205,618,118	165,930,003	1,493,440	81.4
June 30, 2011	187,992,269	183,670,467		97.7

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, 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
June 30, 2010	18,764,941	9,489,399		50.6
June 30, 2011	18,463,372	12,657,225		68.6

Insurance				
Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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
June 30, 2010	30,302,151	8,643,112	273,684	29.4
June 30, 2011	25,772,574	11,050,964		42.9

Total				
Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
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	26.1
June 30, 2009	45,276,507	15,599,811	229,240	35.0
June 30, 2010	49,067,092	18,132,511	273,684	37.5
June 30, 2011	44,235,946	23,708,189		53.6

ADDITIONAL SUPPORTING SCHEDULES

KENTUCKY RETIREMENT SYSTEMS

Schedule of Administrative Expenses

For the Fiscal Years Ended June 30, 2011 and 2010

	2011	2010
	(Dollars in thousands)	
Personnel		
Salaries and Per Diem	\$ 13,889	\$ 13,678
Fringe Benefits	5,179	4,407
Tuition Assistance	23	27
Total Personal Services	19,091	18,112
Contractual Services		
Actuarial	270	251
Audit	111	58
Legal	231	308
Medical	306	273
Contractual	1,353	719
Total Contractual Services	2,271	1,609
Communication		
Printing	286	302
Telephone	118	143
Postage	593	577
Travel	118	163
Total Communication	1,115	1,185
Rentals		
Office Space	1,125	1,106
Equipment	90	91
Total Rentals	1,215	1,197
Miscellaneous		
Utilities	217	195
Supplies	176	156
Insurance	78	80
Maintenance	5	4
Other		1,447
Total Miscellaneous	476	1,882
Depreciation/Amortization	750	863
Total Pension Fund Administrative Expense	24,918	24,848
Healthcare Administrative Fees	10,412	9,703
Total Administrative Expenses	\$ 35,330	\$ 34,551

KENTUCKY RETIREMENT SYSTEMS

Schedule of Investment Expenses

For the Fiscal Years Ended June 30, 2011 and 2010

	2011	2010
	(Dollars in thousands)	
PENSION FUNDS		
Security Lending Fees		
Broker Rebates	\$ 2,277	\$ 1,755
Lending Agent Fees	1,162	1,445
Total Security Lending	3,439	3,200
Common Stock Commissions	7,643	7,374
Contractual Services		
Investment Management	47,265	33,492
Security Custody	203	155
Investment Consultant	876	880
Investment Related Travel	27	29
Software	148	125
Miscellaneous	113	10
Legal Counsel	943	736
Total Contractual Services	49,575	35,427
INSURANCE FUND		
Security Lending Fees		
Broker Rebates	240	71
Lending Agent Fees	325	306
Total Security Lending	565	377
Common Stock Commissions	1,236	1,200
Contractual Services		
Investment Management	7,323	5,007
Security Custody	47	32
Investment Consultant	293	270
Investment Related Travel	6	6
Miscellaneous	26	2
Software	34	26
Legal Counsel	23	22
Total Contractual Services	7,752	5,365
Total Investment Expenses	\$ 70,210	\$ 52,943

KENTUCKY RETIREMENT SYSTEMS

Schedule of Professional Consultant Fees

For the Fiscal Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
	(Dollars in thousands)	
Actuarial Services	\$ 270	\$ 251
Medical Review Services	306	273
Audit Services	111	58
Legal Counsel	231	308
Compliance	771	
Workflow	209	392
Healthcare	113	166
Banking	55	47
Miscellaneous	<u>205</u>	<u>114</u>
Total	<u>\$ 2,271</u>	<u>\$ 1,609</u>

DEAN || DORTON || ALLEN || FORD^{LLC}

**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, 2011, and have issued our report thereon dated November 17, 2011. 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.

Dean Doctor Allen Ford, PLLC

November 17, 2011
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*.