

# KENTUCKY RETIREMENT SYSTEMS

Financial Statements and Supplementary Information

*For the Fiscal Years Ended June 30, 2012 and 2011  
With Independent Auditors' Report Thereon*



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DEAN || DORTON || ALLEN || FORD<sup>llc</sup>**Independent Auditors' Report**

Board of Trustees  
 Kentucky Retirement Systems  
 Frankfort, Kentucky

We have audited the accompanying combining financial statements of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of and for the fiscal years ended June 30, 2012 and 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 opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Kentucky Retirement Systems' internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

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, 2012 and 2011, and the changes in plan net assets for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 5, 2012, on our consideration of the Kentucky Retirement Systems' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and 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 audits.

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Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis (pages 3 through 10) and the Schedules of Funding Progress and Schedules of Contributions from Employers and Other Contributing Entities (pages 59 through 69) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming opinions on the combining financial statements of the Kentucky Retirement Systems as a whole. The additional supporting schedules (pages 70 through 73) are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic 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 basic financial statements as a whole.

As described in Note S to the combining financial statements, the 2011 financial statements have been restated to correct accrued pension and insurance contributions as of June 30, 2011.

*Dean Dotson Allen Ford, PLLC*

December 5, 2012  
Lexington, Kentucky

## KENTUCKY RETIREMENT SYSTEMS

### Management's Discussion and Analysis

June 30, 2012

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, 2012. Please read it in conjunction with the financial statements, which begin on page 11.

#### Financial Highlights-Pension Funds

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

- The combined plan net assets of all pension funds administered by Kentucky Retirement Systems decreased by \$859.1 million during fiscal 2012.
- Member and Employer contributions reported for fiscal 2012, totaled \$877.4 million compared to \$819.2 million (as restated) in fiscal 2011. This increase is due to an increase in the employer contribution rates and the collection of additional health insurance contributions passed by House Bill 1 in September 2008.
- The Pension Funds' Net Assets as of June 30, 2011, and the increase in the Pension Funds for the fiscal year then ended, have been restated to correct accrued contributions as of June 30, 2011. The net effect of this correction for reporting purposes is a decrease of \$62.8 million in pension contributions for the fiscal year ended June 30, 2011, and a corresponding decrease in the Pension Funds' Net Assets as of June 30, 2011. The restatement resulted from the double posting of an accrual of contributions in fiscal 2011.
- The net depreciation in the fair value of investments was \$261.2 million for the fiscal year ended June 30, 2012 compared to net appreciation of \$1,658.5 million for the prior fiscal year. Included in this net depreciation in fiscal 2012 were realized losses on sales of investments of \$22.8 million.
- The plan allocations for the Pension Investment Accounts in which exposure to the Record Currency Management Dynamic Currency Hedging Program (RCM) were adjusted. This adjustment is a revision of previously estimated plan allocation percentages applied. Individual gains and losses were revised using updated estimates; however, there was no change to the net balance of the RCM Pension Account. An additional minor adjustment may be needed once final disposition of the RCM account is complete. In accordance with accounting principles generally accepted in the United States, this is deemed a change in estimate. A change in estimate is accounted for only in current and future years; prior years are not adjusted. The audited financial statements for fiscal 2012 include Footnote D regarding the nature and reasons for the change.
- Interest, dividend and net securities lending income was \$270.3 million compared to \$300.9 million in fiscal 2011.

## KENTUCKY RETIREMENT SYSTEMS

### Management's Discussion and Analysis, continued

June 30, 2012

#### Financial Highlights-Pension Funds, continued

- Pension benefits paid to retirees and beneficiaries totaled \$1,649.2 million compared to \$1,591.5 million in fiscal 2011. Refund of contributions paid to former members upon termination of employment totaled \$30.9 million compared to \$27.5 million in fiscal 2011.
- Administrative expense totaled \$27.8 million compared to \$24.9 million in the prior fiscal year. A supplemental appropriation of \$12.96 million was approved by the State Budget Office in fiscal 2012. This supplemental appropriation enabled KRS to implement recommendations of the Kentucky Auditor of Public Accounts to include certain health and investment administrative expenses for the first time in the KRS administrative budget. Capital Project Expenses incurred, as a result of the START Project, totaled approximately \$17,000. Certain START Project costs were capitalized in fiscal 2012 between fixed assets and intangible assets, as appropriate.
- The Kentucky Auditor of Public Accounts recommended that KRS include expenses for the health care fees, investments, and internal audit as separate line items of the Administrative Expense budget. This has been implemented in fiscal 2012; see pages 70 and 71.
- The member health insurance contribution, as a result of the passage of House Bill 1 (effective September 1, 2008) totaled \$11.9 million, for the fiscal year ended June 30, 2012, compared to \$6.6 million (as restated) in the prior fiscal year.

#### Financial Highlights-Insurance Fund

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

- The combined plan net assets of the insurance fund administered by Kentucky Retirement Systems increased by \$41.1 million during fiscal 2012.
- Premiums received from retirees who participated in the Medicare eligible self-funded plan totaled \$28.4 million, compared to \$31 million in fiscal 2011. The decrease is a result of CMS paying a portion of the retiree's premium. In addition, the decrease is attributable to changes in coverage chosen by retirees.
- Employer contributions of \$436.2 million were received compared to \$387.5 million (as restated) in fiscal 2011. This increase is due to an increase in the insurance contribution rate.

## KENTUCKY RETIREMENT SYSTEMS

### Management's Discussion and Analysis, continued

June 30, 2012

#### Financial Highlights-Insurance Fund, continued

- The Insurance Funds' net assets as of June 30, 2011, and the increase in the insurance funds for the fiscal year then ended, have been restated to correct accrued contributions as of June 30, 2011. The net effect of this correction for reporting purposes is a decrease of \$48.5 million in insurance contributions for the fiscal year ended June 30, 2011, and a corresponding decrease in the Insurance Funds' net assets as of June 30, 2011. The restatement resulted from the double posting of an accrual of contributions in fiscal 2011.
- The Employer Group Waiver Plan receipts from the Centers for Medicare and Medicaid Services (CMS) subsidies totaled \$17.8 million compared to \$22.1 million in fiscal 2011. Changes in receipts depend upon the fluctuation of membership in the Plan.
- The net depreciation in the fair value of investments was \$118.7 million compared to net appreciation of \$517.0 million for the prior fiscal year. Included in this net depreciation in fiscal 2012 were realized losses on sales of investments of \$97.7 million.
- The plan allocations for the Insurance Investment Accounts in which exposure to the Record Currency Management Dynamic Currency Hedging Program (RCM) were adjusted. This adjustment is a revision of previously estimated plan allocation percentages applied. Individual gains and losses were revised using updated estimates; however, there was no change to the net balance of the RCM Insurance Account. An additional minor adjustment may be needed once final disposition of the RCM account is complete. In accordance with accounting principles generally accepted in the United States, this is deemed a change in estimate. A change in estimate is accounted for only in current and future years; prior years are not adjusted. The audited financial statements for fiscal 2012 include Footnote D regarding the nature and reasons for the change.
- Interest, dividend and net securities lending income was \$71.4 million compared to \$53.1 million in fiscal 2011.
- Premiums paid by the fund for hospital and medical insurance coverage (under age 65) totaled \$248.3 million. Payments for the self-funded healthcare reimbursements (over age 65) totaled \$132.1 million. The total of insurance premiums paid plus self-funded reimbursements was \$380.4 million for fiscal 2012. Insurance premiums paid plus self-funded healthcare reimbursements for the prior plan year totaled \$373.1 million. On August 6, 2012, the Board of Trustees voted to cease self-funding of healthcare benefits for most KRS Medicare eligible retirees. The Board elected to contract with Humana Insurance Company to provide healthcare benefits to KRS' retirees through a fully-insured Medicare Advantage Plan. The Humana Medicare Advantage Plan becomes effective January 1, 2013.



## KENTUCKY RETIREMENT SYSTEMS

### Management's Discussion and Analysis, continued

June 30, 2012

#### 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, 2012, totaled \$100,691.
- The reimbursement of retired-reemployed health insurance, as a result of the passage of House Bill 1 (effective September 1, 2008), totaled \$6.3 million for the fiscal year ended June 30, 2012, compared to \$4.0 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 11, and the Combined Statement of Plan Net Assets for the Insurance Fund, on page 14, provide a snapshot of the financial position of each of the three systems at June 30, 2012. The Combined Statement of Changes in Plan Net Assets for the Pension Funds, on pages 12-13, and the Combined Statement of Changes in Plan Net Assets for the Insurance Fund, on pages 15-16, summarize the additions and deductions that occurred for each of the three systems during fiscal 2012.

The Schedules of Funding Progress, on pages 59-64, include 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 Schedules of Contributions from Employers and Other Contributing Entities, on pages 65-69, present 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, 2012

#### Kentucky Retirement Systems as a Whole

Kentucky Retirement Systems' combined plan net assets decreased, during the fiscal year ended June 30, 2012, by \$818 million from \$14,666 million to \$13,848 million. Restated plan net assets for the prior fiscal year increased by \$1,699.6 million. The decrease in plan net assets for the plan year ended June 30, 2012 is primarily attributable to a net depreciation in the fair value of investments, an increase in benefit payments, a decrease in member contributions and decrease in securities lending income. 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		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
Cash & Invest.	\$ 11,922.7	\$ 13,217.3	\$ 12,690.2	\$ 3,243.5	\$ 3,458.4	\$ 2,961.3	\$ 15,166.2	\$ 16,675.7	\$ 15,651.5
Receivables	150.2	115.3	108.6	71.9	32.3	33.6	222.1	147.6	142.2
Equip/Int Assets, net of dep/amort.	13.8	9.7	9.3				13.8	9.7	9.3
<b>Total Assets</b>	<b>12,086.7</b>	<b>13,342.3</b>	<b>12,808.1</b>	<b>3,315.4</b>	<b>3,490.7</b>	<b>2,994.9</b>	<b>15,402.1</b>	<b>16,833.0</b>	<b>15,803.0</b>
<b>Total Liabilities</b>	<b>(1,328.1)</b>	<b>(1,724.6)</b>	<b>(2,267.7)</b>	<b>(226.0)</b>	<b>(442.4)</b>	<b>(568.9)</b>	<b>(1,554.1)</b>	<b>(2,167.0)</b>	<b>(2,836.6)</b>
<b>Plan Net Assets</b>	<b>\$ 10,758.6</b>	<b>\$ 11,617.7</b>	<b>\$ 10,540.4</b>	<b>\$ 3,089.4</b>	<b>\$ 3,048.3</b>	<b>\$ 2,426.0</b>	<b>\$ 13,848.0</b>	<b>\$ 14,666.0</b>	<b>\$ 12,966.4</b>

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

	Pension Funds			Insurance Fund			Total		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
<b>Additions:</b>									
Member Cont.	\$ 274.1	\$ 306.0	\$ 249.8	\$ -	\$ -	\$ -	\$ 274.1	\$ 306.0	\$ 249.8
Employer Cont.	591.4	506.6	461.2	436.2	387.5	371.9	1,027.6	894.1	833.1
Health Ins. Cont.	11.9	6.6	3.4				11.9	6.6	3.4
Premiums Rec'd				28.4	31.0	29.1	28.4	31.0	29.1
Retired Remp Ins.				6.3	4.0	2.0	6.3	4.0	2.0
Medicare Subsidy				17.8	22.1	19.8	17.8	22.1	19.8
Invest. Inc. (net)	(28.5)	1,902.2	1,507.5	(55.3)	561.2	310.1	(83.8)	2,463.4	1,817.6
<b>Total Additions</b>	<b>848.9</b>	<b>2,721.4</b>	<b>2,221.9</b>	<b>433.4</b>	<b>1,005.8</b>	<b>732.9</b>	<b>1,282.3</b>	<b>3,727.2</b>	<b>2,954.8</b>
<b>Deductions:</b>									
Benefit payments	1,649.2	1,591.5	1,516.1				1,649.2	1,591.5	1,516.1
Refunds	31.0	27.5	22.3				31.0	27.5	22.3
Administrative Ex.	27.8	24.9	24.8	11.9	10.4	9.7	39.7	35.3	34.5
Capital Projects Ex.		0.2						0.2	
Healthcare Costs				380.4	373.1	353.4	380.4	373.1	353.4
<b>Total Deductions</b>	<b>1,708.0</b>	<b>1,644.1</b>	<b>1,563.2</b>	<b>392.3</b>	<b>383.5</b>	<b>363.1</b>	<b>2,100.3</b>	<b>2,027.6</b>	<b>1,926.3</b>
<b>Inc. (Decrease) in Plan Net Assets</b>	<b>\$ (859.1)</b>	<b>\$ 1,077.3</b>	<b>\$ 658.7</b>	<b>\$ 41.1</b>	<b>\$ 622.3</b>	<b>\$ 369.8</b>	<b>\$ (818.0)</b>	<b>\$ 1,699.6</b>	<b>\$ 1,028.5</b>

## KENTUCKY RETIREMENT SYSTEMS

### Management's Discussion and Analysis, continued

June 30, 2012

#### Kentucky Retirement Systems as a Whole, continued

Plan net assets of the pension funds decreased by \$859.4 million (\$10,758.7 million compared to \$11,617.7 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. Plan net assets of the insurance fund increased by \$41.4 million (\$3,089.7 million compared to \$3,048.3 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. The increase in net plan assets is primarily attributable to the increase in employer contribution rates for insurance.

#### Pension Fund Activities

After the restatement of fiscal 2011 contributions, member contributions decreased by \$31.9 million. Retirement contributions are calculated by applying a percentage factor to salary and are remitted by each employer on behalf of the member. Nonhazardous members pay pension contributions of 5% of creditable compensation and hazardous members contribute 8% of creditable compensation. Members may also pay contributions to repurchase previously refunded service credit or to purchase various types of elective service credit.

After the restatement of fiscal 2011 contributions, employer contributions increased by \$84.8 million due to the increase in employer contribution rate applied to covered payroll.

Net investment income decreased by \$1,930.7 million (a \$28.5 million net investment loss in fiscal 2012 compared to \$1,902.2 million net investment income in fiscal 2011). This can be illustrated in Table 3. The pension funds experienced a decrease in income primarily due to a decrease in investment income.

Table 3	In Millions		
Investment (Loss) Income -Pension	2012	2011	2010
(Decrease) increase in fair value of investments	\$ (238)	\$ 707	\$ 1,066
Investment income net of investment expense	232	244	224
(Loss) gain on sale of investments	(23)	951	218
Net investment (loss) income	\$ (29)	\$ 1,902	\$ 1,508

Pension fund deductions increased by \$63.9 million caused principally by an increase of \$57.7 million in benefit payments. Retirees received a Cost of Living Adjustment (COLA) increase of 1.5% in benefit payments as of July 1, 2011. Refunds of member contributions increased by \$3.5 million and administrative expenses increased by \$2.9 million. Capital Project Expenses, incurred as a result of the START Project, totaled \$0.02 million. Certain START Project costs were capitalized in fiscal 2012 between fixed assets and intangible assets, as appropriate.

## KENTUCKY RETIREMENT SYSTEMS

### Management's Discussion and Analysis, continued

June 30, 2012

#### Insurance Fund Activities

After the restatement of fiscal 2011 contributions, employer contributions paid into the insurance fund increased by \$48.7 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 decreased \$616.5 million. This decrease in net investment income is due primarily to the loss on sale of investments. This is illustrated in Table 4 as follows:

<b>Table 4</b>	<b>In Millions</b>		
<b>Investment (Loss) Income -Insurance</b>	<u>2012</u>	<u>2011</u>	<u>2010</u>
(Decrease) increase in fair value of investments	\$ (21)	\$ 169	\$ 183
Investment income net of investment expense	63	44	35
(Loss) gain on sale of investments	(97)	348	92
Net investment (loss) income	<u>\$ (55)</u>	<u>\$ 561</u>	<u>\$ 310</u>

Insurance fund deductions increased by \$8.8 million due to the increase in overall healthcare costs.

#### 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 Schedules of Funding Progress on pages 59-64. The asset value stated in the Schedules 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 \$1,375.5 million for a total unfunded amount of \$13,758.0 million for the fiscal year ended June 30, 2012, compared to an unfunded amount of \$12,382.5 million for the fiscal year ended June 30, 2011. In recent years, funding levels for the pension funds have fallen dramatically due to investment returns less than the actuarially assumed rate, higher than anticipated retirement rates, and expenditures for unfunded retiree Cost of Living Adjustments. In addition, KERS, KERS Hazardous, and SPRS are funded less than the actuarially determined rate. 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.

## KENTUCKY RETIREMENT SYSTEMS

### Management's Discussion and Analysis, continued

June 30, 2012

#### Historical Trends, continued

The insurance plan's unfunded actuarial accrued liability for the plan year ended June 30, 2012, decreased to \$4,321.5 million from \$6,837.7 million for the plan year ended June 30, 2011. This is a decrease in the unfunded actuarial accrued liability of \$2,516.2 million. This decrease is due to the change for the Medicare-eligible retirees from the self-insured health plans to fully insured Medicare Advantage plans administered by Humana.

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 Schedules 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 fact that the employer contribution rate set by the Kentucky General Assembly is less than the rate recommended by the KRS Actuary and adopted by the KRS Board of Trustees.

## KENTUCKY RETIREMENT SYSTEMS

### Combining Statement of Plan Net Assets-Pension Funds

As of June 30, 2012 (with Comparative Totals As of June 30, 2011)

(Dollars in Thousands)

	2012					2011 (Restated)	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
<b>ASSETS</b>							
<b>Cash and Short-Term Investments</b>							
Cash	\$ 316	\$ 1,024	\$ 592	\$ 760	\$ 246	\$ 2,938	\$ 2,740
Short-Term Investments	18,546	101,548	59,946	183,733	11,566	375,339	1,309,337
<b>Total Cash and Short-Term Investments</b>	<b>18,862</b>	<b>102,572</b>	<b>60,538</b>	<b>184,493</b>	<b>11,812</b>	<b>378,277</b>	<b>1,312,077</b>
<b>Receivables</b>							
Contributions	4,664	40,290	14,188	51,375	2,205	112,722	75,965
Investment Income	1,641	10,273	5,872	18,895	842	37,523	39,310
<b>Total Receivables</b>	<b>6,305</b>	<b>50,563</b>	<b>20,060</b>	<b>70,270</b>	<b>3,047</b>	<b>150,245</b>	<b>115,275</b>
<b>Investments, at fair value</b>							
Corporate and Government Bonds	159,055	972,045	573,583	1,850,724	83,980	3,639,387	2,882,891
Equity Contracts	2	14	8	25	1	50	868,796
Interest Rate Contracts	1,326	8,165	4,598	14,709	679	29,477	368,604
Foreign Exchange Contracts	2,798	17,225	9,701	31,030	1,430	62,184	
Swaps	70	430	242	774	36	1,552	
Options	39	242	136	436	20	873	
Corporate Stocks	274,644	1,757,066	957,644	3,061,343	144,779	6,195,476	5,280,654
Mortgages	11,677	69,786	43,460	142,047	5,671	272,641	751,453
Real Estate	4,516	12,891	10,036	25,160	1,444	54,047	32,252
<b>Total Investments, at fair value</b>	<b>454,127</b>	<b>2,837,864</b>	<b>1,599,408</b>	<b>5,126,248</b>	<b>238,040</b>	<b>10,255,687</b>	<b>10,184,650</b>
Securities Lending Collateral Invested	33,456	731,422	120,548	385,278	18,109	1,288,813	1,720,595
Equipment (net of accumulated depreciation)	112	1,328	200	2,284	25	3,949	3,984
Intangible Assets (net of accumulated amortization)	290	3,335	483	5,671	53	9,832	5,744
<b>Total Assets</b>	<b>513,152</b>	<b>3,727,084</b>	<b>1,801,237</b>	<b>5,774,244</b>	<b>271,086</b>	<b>12,086,803</b>	<b>13,342,325</b>
<b>LIABILITIES</b>							
Accounts Payable	3,107	18,593	7,719	7,364	2,501	39,284	4,010
Securities Lending Collateral Obligations	33,456	731,422	120,548	385,278	18,109	1,288,813	1,720,595
<b>Total Liabilities</b>	<b>36,563</b>	<b>750,015</b>	<b>128,267</b>	<b>392,642</b>	<b>20,610</b>	<b>1,328,097</b>	<b>1,724,605</b>
<b>Plan Net Assets Held in Trust for</b>							
Pension Benefits	\$ 476,589	\$ 2,977,069	\$ 1,672,970	\$ 5,381,602	\$ 230,476	\$ 10,758,706	\$ 11,617,720

See accompanying notes to the combining financial statements.

## KENTUCKY RETIREMENT SYSTEMS

### Combining Statement of Changes in Plan Net Assets-Pension Funds

For the Fiscal Year Ended June 30, 2012 (with Comparative Totals For the Fiscal Year Ended June 30, 2011)

(Dollars in Thousands)

	2012					2011 (Restated)	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
<b>ADDITIONS</b>							
Members' Contributions	\$ 11,602	\$ 96,418	\$ 41,797	\$ 119,123	\$ 5,154	\$ 274,094	\$ 306,033
Employers' Contributions	17,367	211,071	77,311	270,664	15,040	591,453	506,592
Health Insurance Contributions (HB1)	<u>629</u>	<u>5,337</u>	<u>811</u>	<u>5,101</u>	<u>46</u>	<u>11,924</u>	<u>6,586</u>
<b>Total Contributions</b>	29,598	312,826	119,919	394,888	20,240	877,471	819,211
<b>INVESTMENT (LOSS) INCOME</b>							
From Investing Activities:							
Net (Depreciation) Appreciation in Fair Value of Investments	(20,338)	(57,548)	(60,565)	(117,311)	(5,418)	(261,180)	1,658,548
Interest/Dividends	<u>11,672</u>	<u>79,998</u>	<u>41,001</u>	<u>130,934</u>	<u>6,419</u>	<u>270,024</u>	<u>296,549</u>
<b>Total Investing Activities (Loss) Income</b>	(8,666)	22,450	(19,564)	13,623	1,001	8,844	1,955,097
Investment Expense	1,461	11,550	4,604	14,986	870	33,471	49,575
Commissions	<u>185</u>	<u>1,260</u>	<u>650</u>	<u>2,062</u>	<u>102</u>	<u>4,259</u>	<u>7,643</u>
<b>Total Investing Activities Expense</b>	1,646	12,810	5,254	17,048	972	37,730	57,218
<b>Net (Loss) Income from Investing Activities</b>	<u>(10,312)</u>	<u>9,640</u>	<u>(24,818)</u>	<u>(3,425)</u>	<u>29</u>	<u>(28,886)</u>	<u>1,897,879</u>
From Securities Lending Activities:							
Securities Lending Income	25	141	89	59	13	327	7,783
Securities Lending Expense:							
Security Borrower (Income) Rebates	(11)	(71)	(41)	(132)	(6)	(261)	2,277
Security Lending Agent Fees	<u>10</u>	<u>63</u>	<u>36</u>	<u>115</u>	<u>5</u>	<u>229</u>	<u>1,162</u>
<b>Net Income from Securities Lending Activities</b>	<u>26</u>	<u>149</u>	<u>94</u>	<u>76</u>	<u>14</u>	<u>359</u>	<u>4,314</u>
<b>Total Net Investment (Loss) Income</b>	<u>(10,286)</u>	<u>9,789</u>	<u>(24,724)</u>	<u>(3,349)</u>	<u>43</u>	<u>(28,527)</u>	<u>1,902,223</u>
<b>Total Additions</b>	19,312	322,615	95,195	391,539	20,283	848,944	2,721,434

## KENTUCKY RETIREMENT SYSTEMS

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

For the Fiscal Year Ended June 30, 2012 (with Comparative Totals For the Fiscal Year Ended June 30, 2011)

(Dollars in Thousands)

	2012					2011 (Restated)	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
	<b>DEDUCTIONS</b>						
Benefit Payments	48,424	858,151	169,352	524,385	48,867	1,649,179	1,591,519
Refunds	2,543	12,004	3,516	12,765	149	30,977	27,521
Administrative Expenses	877	8,776	1,319	16,740	73	27,785	24,918
Capital Project Expenses	<u>          </u>	<u>          8</u>	<u>          </u>	<u>          9</u>	<u>          </u>	<u>          17</u>	<u>          195</u>
<b>Total Deductions</b>	<u>51,844</u>	<u>878,939</u>	<u>174,187</u>	<u>553,899</u>	<u>49,089</u>	<u>1,707,958</u>	<u>1,644,153</u>
<b>Net (Decrease) Increase in Plan Assets</b>	(32,532)	(556,324)	(78,992)	(162,360)	(28,806)	(859,014)	1,077,281
<b>Plan Net Assets Held in Trust for Pension Benefits</b>							
Beginning of Year	<u>509,121</u>	<u>3,533,393</u>	<u>1,751,962</u>	<u>5,543,962</u>	<u>279,282</u>	<u>11,617,720</u>	<u>10,540,439</u>
End of Year	<u>\$ 476,589</u>	<u>\$ 2,977,069</u>	<u>\$ 1,672,970</u>	<u>\$ 5,381,602</u>	<u>\$ 250,476</u>	<u>\$ 10,758,706</u>	<u>\$ 11,617,720</u>

See accompanying notes to the combining financial statements.



## KENTUCKY RETIREMENT SYSTEMS

### Combining Statement of Plan Net Assets-Insurance Fund

As of June 30, 2012 (with Comparative Totals As of June 30, 2011)

(Dollars in Thousands)

	2012					2011 (Restated)	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
<b>ASSETS</b>							
<b>Cash and Short-Term Investments</b>							
Cash	\$ 34	\$ 555	\$ 39	\$ 570	\$ 34	\$ 1,232	\$ 2,016
Short-Term Investments	24,366	33,748	39,452	80,072	7,748	185,386	758,893
Medicare Drug Deposit	11	20	23	42	5	101	101
<b>Total Cash and Short-Term Investments</b>	<b>24,411</b>	<b>34,323</b>	<b>39,514</b>	<b>80,684</b>	<b>7,787</b>	<b>186,719</b>	<b>761,010</b>
<b>Receivables</b>							
Contributions	5,544	15,908	16,169	20,705	2,996	61,322	23,276
Investment Income	1,133	1,302	2,732	5,024	425	10,616	9,066
<b>Total Receivables</b>	<b>6,677</b>	<b>17,210</b>	<b>18,901</b>	<b>25,729</b>	<b>3,421</b>	<b>71,938</b>	<b>32,342</b>
<b>Investments, at fair value</b>							
Corporate and Government Bonds	122,004	123,864	282,365	515,716	41,542	1,085,491	593,589
Equity Contracts			1	1		2	527,274
Interest Rate Contracts	772	961	1,856	3,399	291	7,279	33,584
Swaps	30	38	74	135	12	289	328
Foreign Exchange Contracts	2,399	2,987	5,771	10,568	905	22,630	
Options	15	19	37	68	6	145	
Corporate Stocks	168,218	232,238	419,192	770,083	68,481	1,658,212	984,724
Mortgages	7,079	17,798	16,592	31,071	2,807	75,347	116,447
Real Estate	950	519	2,196	4,058	378	8,101	2,523
<b>Total Investments, at fair value</b>	<b>301,467</b>	<b>378,424</b>	<b>728,084</b>	<b>1,335,099</b>	<b>114,422</b>	<b>2,857,496</b>	<b>2,258,469</b>
<b>Security Lending Collateral Invested</b>	<b>19,920</b>	<b>31,234</b>	<b>49,003</b>	<b>91,073</b>	<b>7,988</b>	<b>199,218</b>	<b>438,877</b>
<b>Total Assets</b>	<b>352,475</b>	<b>461,191</b>	<b>835,502</b>	<b>1,532,585</b>	<b>133,618</b>	<b>3,315,371</b>	<b>3,490,698</b>
<b>LIABILITIES</b>							
Accounts Payable	1,825	11,467	625	12,691	232	26,840	3,483
Securities Lending Collateral Obligations	19,920	31,234	49,003	91,073	7,988	199,218	438,877
<b>Total Liabilities</b>	<b>21,745</b>	<b>42,701</b>	<b>49,628</b>	<b>103,764</b>	<b>8,220</b>	<b>226,058</b>	<b>442,360</b>
<b>Plan Net Assets Held in Trust for</b>							
<b>Insurance Benefits</b>	<b>\$ 330,730</b>	<b>\$ 418,490</b>	<b>\$ 785,874</b>	<b>\$ 1,428,821</b>	<b>\$ 125,398</b>	<b>\$ 3,089,313</b>	<b>\$ 3,048,338</b>

See accompanying notes to the combining financial statements.

## KENTUCKY RETIREMENT SYSTEMS

### Combining Statement of Changes in Plan Net Assets-Insurance Fund

For the Fiscal Year Ended June 30, 2012 (with Comparative Totals For the Fiscal Year Ended June 30, 2011)

(Dollars in Thousands)

	2012						2011 (Restated)
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
<b>ADDITIONS</b>							
Employers' Contributions	\$ 23,984	\$ 146,844	\$ 90,204	\$ 164,297	\$ 10,808	\$ 436,137	\$ 387,525
Employer Group Waiver Plan	351	7,856	871	8,443	279	17,800	22,129
Premiums Received from Retirees	339	12,229	290	15,525	20	28,403	30,959
Retired Reemployed Healthcare (HB1)	<u>537</u>	<u>3,437</u>	<u>405</u>	<u>1,968</u>	<u>2</u>	<u>6,349</u>	<u>4,042</u>
<b>Total Contributions</b>	25,211	170,366	91,770	190,233	11,109	488,689	444,655
<b>INVESTMENT (LOSS) INCOME</b>							
From Investing Activities:							
Net (Depreciation) Appreciation in Fair Value of Investments	(6,675)	(12,575)	(32,299)	(63,013)	(4,139)	(118,701)	517,042
Interest/Dividends	<u>7,702</u>	<u>9,167</u>	<u>17,951</u>	<u>33,381</u>	<u>3,040</u>	<u>71,241</u>	<u>51,808</u>
<b>Total Investing Activities (Loss) Income</b>	1,027	(3,408)	(14,348)	(29,632)	(1,099)	(47,460)	568,850
Investment Expense	857	1,196	1,517	2,870	314	6,754	7,752
Commissions	<u>128</u>	<u>224</u>	<u>304</u>	<u>568</u>	<u>51</u>	<u>1,275</u>	<u>1,236</u>
<b>Total Investing Activities Expense</b>	985	1,420	1,821	3,438	365	8,029	8,988
<b>Net (Loss) Income from Investing Activities</b>	<u>42</u>	<u>(4,828)</u>	<u>(16,169)</u>	<u>(33,070)</u>	<u>(1,464)</u>	<u>(55,489)</u>	<u>559,862</u>
From Securities Lending Activities:							
Securities Lending Income	9	12	21	39	3	84	1,891
Securities Lending Expense:							
Security Borrower (Income) Rebates	(16)	(23)	(38)	(70)	(6)	(153)	240
Security Lending Agent Fees	<u>7</u>	<u>10</u>	<u>17</u>	<u>31</u>	<u>3</u>	<u>68</u>	<u>325</u>
<b>Net Income from Securities Lending Activities</b>	<u>18</u>	<u>25</u>	<u>42</u>	<u>78</u>	<u>6</u>	<u>169</u>	<u>1,326</u>
<b>Total Net Investment (Loss) Income</b>	<u>60</u>	<u>(4,803)</u>	<u>(16,127)</u>	<u>(32,992)</u>	<u>(1,458)</u>	<u>(55,320)</u>	<u>561,188</u>
<b>Total Additions</b>	25,271	165,563	75,643	157,241	9,651	433,369	1,005,843

## KENTUCKY RETIREMENT SYSTEMS

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

For the Fiscal Year Ended June 30, 2012 (with Comparative Totals For the Fiscal Year Ended June 30, 2011)

(Dollars in Thousands)

	2012					2011 (Restated)	
	KERS Hazardous	KERS Non- Hazardous	CERS Hazardous	CERS Non- Hazardous	SPRS	Total	Total
<b>DEDUCTIONS</b>							
Healthcare Premiums Subsidies	11,047	104,900	44,225	79,378	8,728	248,278	242,818
Administrative Fees	335	5,203	688	5,545	201	11,972	10,412
Self Funding Insurance Costs	2,894	58,941	5,930	62,316	2,063	132,144	130,260
<b>Total Deductions</b>	<u>14,276</u>	<u>169,044</u>	<u>50,843</u>	<u>147,239</u>	<u>10,992</u>	<u>392,394</u>	<u>383,490</u>
Net Increase in Plan Assets	10,995	(3,481)	24,800	10,002	(1,341)	40,975	622,353
<b>Plan Net Assets Held in Trust for Insurance Benefits</b>							
Beginning of Year	<u>319,735</u>	<u>421,971</u>	<u>761,074</u>	<u>1,418,819</u>	<u>126,739</u>	<u>3,048,338</u>	<u>2,425,985</u>
End of Year	<u>\$ 330,730</u>	<u>\$ 418,490</u>	<u>\$ 785,874</u>	<u>\$ 1,428,821</u>	<u>\$ 125,398</u>	<u>\$ 3,089,313</u>	<u>\$ 3,048,338</u>

See accompanying notes to the combining financial statements.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining 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, and a pro rata share of administrative costs, 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' combining 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. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Short-term investments are reported at cost, which approximates fair value. See Note D for further discussion of fair value measurements. Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date. Gain (loss) on investments includes KRS' gains and losses on investments bought and sold as well held during the fiscal year.

##### 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 Combining 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 2012 and 2011 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 2012 and 2011 was \$3,000 (see Note K for further information).

#### Contributions Receivable

Contributions receivable consist of amounts due from employers. The management of KRS considers contributions receivable to be fully collectible; accordingly, no allowance for doubtful accounts is considered necessary. If amounts become uncollectible, they will be charged to operations when that determination is made. If amounts previously written off are collected, they will be credited to income when received.

#### Payment of Benefits

Benefits are recorded when paid.

#### Expense Allocation

Administrative expenses of KRS are allocated in proportion to the number of active members participating in each plan and direct investment manager expenses are allocated in proportion to the percentage of investment assets held by each plan.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

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

##### 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.

##### Recent Accounting Pronouncements

In December 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 62, "Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements". The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on, or before, November 30, 1989, which does not conflict with, or contradict, GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations; Accounting Principles Board Opinions; and, Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. KRS has noted this Statement and has implemented its requirements.

In June 2011, the GASB issued Statement No. 64, "Derivative Instruments: Application of Hedge Accounting Termination Provisions-an amendment of GASB Statement No. 53". The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. KRS has noted this Statement and has implemented its requirements in an additional disclosure in Footnote D-Investments.

In June 2012, the GASB issued Statement No. 67, "Financial Reporting for Pension Plans-an amendment of GASB Statement No. 25". The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement requires defined benefit pension plans to present two financial statements – a statement of fiduciary net position and a statement of changes in fiduciary net position. In addition, the Statement requires that notes to the financial statements include descriptive information, such as the types of benefits provided, the classes of plan members covered, and the composition of the pension plan's board, among other detailed requirements. This Statement becomes effective for the fiscal year beginning July 1, 2013. KRS is currently reviewing the Statement's requirements.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

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

##### Recent Accounting Pronouncements, continued

In June 2012, the GASB issued Statement No. 68, "Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27". The objective of this Statement is to improve financial reporting by state and local governmental pension plans. In addition, it requires the liability of the employers and nonemployer contributing entities to employees for defined benefit pensions (net pension liability) to be measured as the portion of the present value of projected benefit payments to be provided through the pension plan to current active and inactive employees that is attributed to those employees' past periods of service (total pension liability), less the amount of the pension plan's fiduciary net position. In addition, this Statement requires additional changes to the Required Supplementary Information, among other extensive changes. This Statement becomes effective for the fiscal year beginning July 1, 2014. KRS is currently reviewing the Statement's requirements.

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

Membership in each retirement plan consisted of the following at June 30, 2012 and 2011:

##### KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	2012			2011		
	Non- Hazardous Position Employees	Hazardous Position Employees	Total	Non- Hazardous Position Employees	Hazardous Position Employees	Total
<u>Number of Members</u>						
Retirees and Beneficiaries						
Receiving Benefits	36,508	2,180	38,688	38,597	3,064	41,661
Inactive Vested Memberships	39,445	2,490	41,935	38,597	3,264	41,861
Active Plan Members	42,210	3,540	45,750	46,617	4,291	50,908
Total	118,163	8,210	126,373	123,811	10,619	134,430
Number of Participating Employers			385			372

KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

NOTE B-PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION, CONTINUED

COUNTY EMPLOYEES RETIREMENT SYSTEM

	2012			2011		
	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
<u>Number of Members</u>						
Retirees and Beneficiaries						
Receiving Benefits	42,068	5,513	47,581	43,211	6,468	49,679
Inactive Vested Memberships	63,564	1,643	65,207	65,914	2,774	68,688
Active Plan Members	<u>85,779</u>	<u>6,906</u>	<u>92,685</u>	<u>85,285</u>	<u>9,407</u>	<u>94,692</u>
Total	<u>191,411</u>	<u>14,062</u>	<u>205,473</u>	<u>194,410</u>	<u>18,649</u>	<u>213,059</u>
Number of Participating Employers			<u>1,129</u>			<u>1,396</u>

STATE POLICE RETIREMENT SYSTEM

	2012	2011
	Hazardous Position Employees	Hazardous Position Employees
<u>Number of Members</u>		
Retirees and Beneficiaries Receiving Benefits	1,203	1,263
Inactive Vested Memberships	224	357
Active Plan Members	<u>904</u>	<u>965</u>
Total	<u>2,331</u>	<u>2,585</u>
Number of Participating Employers	<u>1</u>	<u>1</u>



KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining 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, 2012 and 2011:

	2012					2011				
	<u>Single</u>	<u>Couple/ Family</u>	<u>Parent</u>	<u>Medicare Without Prescription</u>	<u>Medicare With Prescription</u>	<u>Single</u>	<u>Couple/ Family</u>	<u>Parent</u>	<u>Medicare Without Prescription</u>	<u>Medicare With Prescription</u>
KERS Non-Hazardous	9,764	1,917	734	1,721	15,015	10,321	2,155	732	1,821	13,988
KERS Hazardous	645	517	93	67	751	615	21	75	60	570
CERS Non-Hazardous	7,972	1,317	383	3,119	16,355	8,013	1,552	351	3,167	15,100
CERS Hazardous	1,385	2,237	310	73	1,853	1,310	2,156	253	58	1,527
SPRS	291	444	62	15	581	278	474	52	14	499
Totals	<u>20,057</u>	<u>6,432</u>	<u>1,582</u>	<u>4,995</u>	<u>34,555</u>	<u>20,537</u>	<u>6,358</u>	<u>1,463</u>	<u>5,120</u>	<u>31,684</u>

## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining 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. On July 1, 2012, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2012 and 2011, plan members who began participating prior to September 1, 2008, 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, 2012 and 2011, participating employers contributed 19.82% and 16.98%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2012 and 2011, were 40.71% and 38.58%, 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 for the payment of health insurance benefits 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 Combining Financial Statements, continued

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

#### KENTUCKY EMPLOYEES RETIREMENT SYSTEM, 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. On July 1, 2012, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2012 and 2011, plan members who began participating prior to September 1, 2008, 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, 2012 and 2011, participating employers contributed 28.98% and 26.12%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2012 and 2011, were 33.84% and 34.37%, respectively, of each employee's creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

In accordance with House Bill 1, signed by the Governor on June 27, 2008, plan members who began participating on, or after, September 1, 2008, were required to contribute a total of 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 for the payment of health insurance benefits 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 Combining 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. On July 1, 2012, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2012 and 2011, plan members who began participating prior to September 1, 2008, 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, 2012 and 2011, participating employers contributed 18.96% and 16.93%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2012 and 2011, were 18.96% and 16.93%, 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 for the payment of health insurance benefits 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 Combining Financial Statements, continued

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

#### COUNTY EMPLOYEES RETIREMENT SYSTEM, 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. On July 1, 2012, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2012 and 2011, plan members who began participating prior to September 1, 2008, 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, 2012 and 2011, participating employers contributed 35.76% and 33.25%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2012 and 2011, were 35.76% and 33.25%, 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 for the payment of health insurance benefits 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 Combining 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. On July 1, 2012, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2012 and 2011, plan members who began participating prior to September 1, 2008, 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, 2012 and 2011, the Commonwealth contributed 52.13% and 45.54%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2012 and 2011 were 94.63% and 85.63%, 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 for the payment of health insurance benefits 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 Combining 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, 2012, insurance premiums withheld from benefit payments for members of the systems were \$29,136,828 and \$1,235,155 for KERS non-hazardous and hazardous, respectively; \$27,541,099 and \$1,982,303 for CERS non-hazardous and hazardous, respectively; and, \$246,384 for SPRS. For fiscal 2011, insurance premiums withheld from benefit payments for members of KERS were \$29,350,195 and \$1,225,236 for KERS non-hazardous and KERS hazardous, respectively; \$29,219,273 and \$2,017,208 for CERS non-hazardous and CERS hazardous, respectively; and, \$250,282 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, 2012, the Fund had 96,742 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 Combining 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 contracts with 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.

On August 6, 2012, the Board voted to cease self-funding of healthcare benefits for most KRS Medicare eligible retirees. The Board elected to contract with Humana Insurance Company to provide healthcare benefits to KRS' retirees through a fully-insured Medicare Advantage Plan. The Humana Medicare Advantage Plan becomes effective January 1, 2013.



## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

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

The provisions of 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 accordance with GASB No. 28, KRS classifies certain other investments, not related to the securities lending program, as short-term. Cash and short-term investments consist of the following:

#### KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	<u>2012</u>	<u>2011</u>
Cash	\$ 1,340,506	\$ 1,197,306
Short-Term Investments	120,094,230	387,987,312
Securities Lending Collateral Invested	<u>764,877,463</u>	<u>596,906,253</u>
Total	<u>\$ 886,312,199</u>	<u>\$ 986,090,871</u>

#### COUNTY EMPLOYEES RETIREMENT SYSTEM

	<u>2012</u>	<u>2011</u>
Cash	\$ 1,352,380	\$ 1,250,932
Short-Term Investments	243,678,862	892,898,087
Securities Lending Collateral Invested	<u>505,826,461</u>	<u>1,082,381,468</u>
Total	<u>\$ 750,857,703</u>	<u>\$ 1,976,530,487</u>

#### STATE POLICE RETIREMENT SYSTEM

	<u>2012</u>	<u>2011</u>
Cash	\$ 245,955	\$ 292,029
Short-Term Investments	11,565,956	28,452,304
Securities Lending Collateral Invested	<u>18,109,078</u>	<u>41,306,830</u>
Total	<u>\$ 29,920,989</u>	<u>\$ 70,051,163</u>

## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

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

#### KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND

	2012	2011
Cash	\$ 1,230,685	\$ 2,015,579
Short-Term Investments	185,385,495	758,893,370
Medicare Drug Deposit	100,691	100,620
Securities Lending Collateral Invested	199,217,159	438,877,452
 Total	 \$ 385,934,030	 \$ 1,199,887,021

### 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. For assets not managed internally by staff, 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 common stock, securities convertible into common stock, preferred stock of publicly traded companies on stock markets, asset class relevant ETF's or any other type of security contained in a manager's benchmark. Each individual equity account has a comprehensive set of investment guidelines prepared, which contains a listing of permissible investments, portfolio restrictions and standards of performance.

Fixed Income Investments—The fixed income accounts may include, but are not limited to, the following fixed income securities: US Government and Agency bonds; investment grade US corporate credit; investment grade non-US corporate credit; non-investment grade US corporate credit including both bonds and bank loans; non-investment grade non-US corporate credit including bonds and bank loans; municipal bonds; non-US sovereign debt; mortgages, including residential mortgage backed securities; commercial mortgage backed securities, and whole loans; asset-backed securities and emerging market debt (EMD), including both sovereign EMD and corporate EMD; and, asset class relevant ETF's.

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.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE D-INVESTMENTS, CONTINUED

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, municipal bonds, 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.

KRS' fixed income managers, who utilize cash equivalent securities as an integral part of their investment strategy, are exempt from the permissible investments contained in the preceding paragraph. Permissible short-term investments for fixed income managers shall be included in the investment manager's investment guidelines.

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.

In accordance with GASB Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments", KRS provides this additional disclosure regarding its derivatives:

KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

Background Information

As of June 30, 2012, 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>
<b>Pension:</b>							
<i>Assets</i>							
A	Equity Contracts	Substitute for common stock	\$4,454,530	\$0	\$50,330	Various	\$0
B	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	\$0	\$0	\$29,412,924	Various	\$0
C	Interest Rate Contracts/ Swaps	Hedge against the risk that interest rates will move in an adverse direction	\$11,233,015	\$0	\$18,535,034	Various	\$0
D	Swaps	Hedge against sudden or dramatic shifts in interest rates	\$804,115	\$0	\$744,053	Various	\$0
E	Options	Hedge against the holding of an asset	\$882,930	\$0	\$318,988	Various	\$0
<i>Liabilities</i>							
F	Interest Rate Contracts/ Swaps	Hedge against the risk that interest rates will move in an adverse direction	(\$5,268,395)	\$0	(\$10,941,944)	Various	\$0
G	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	(\$16,007)	\$0	(\$32,771,445)	Various	\$0
H	Swaps	Hedge against sudden or dramatic shifts in interest rates	(\$959,569)	\$0	(\$808,199)	Various	\$0
I	Options	Hedge against the holding of an asset	(\$1,090,105)	\$0	(\$553,615)	Various	\$0

## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

### NOTE D-INVESTMENTS, CONTINUED

<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>
<b>Insurance:</b>							
<i>Assets</i>							
J	Equity Contracts	Substitute for common stock	\$0	\$0	\$2,520	Various	\$0
K	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	\$0	\$0	\$10,852,566	Various	\$0
L	Interest Rate Contracts/ Swaps	Hedge against the risk that interest rates will move in an adverse direction	\$2,505,989	\$0	\$4,528,506	Various	\$0
M	Swaps	Hedge against sudden or dramatic shifts in interest rates	\$96,114	\$0	\$100,127	Various	\$0
N	Options	Hedge against the holding of an asset	\$152,192	\$0	\$52,920	Various	\$0
<i>Liabilities</i>							
O	Interest Rate Contracts/ Swaps	Hedge against the risk that interest rates will move in an adverse direction	(\$1,719,335)	\$0	(\$2,750,159)	Various	\$0
P	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	(\$3,607)	\$0	(\$11,777,583)	Various	\$0
Q	Swaps	Hedge against sudden or dramatic shifts in interest rates	(\$226,846)	\$0	(\$189,210)	Various	\$0
R	Options	Hedge against the holding of an asset	(\$187,000)	\$0	(\$91,819)	Various	\$0

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

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE D-INVESTMENTS, CONTINUED

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 a contract or 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 J are substitutes for common stock with an investment that is recorded at fair value.

Derivative instruments B, G, K and P 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 J 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, G, K, and P 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.

Interest Rate Risk: Derivative instruments C, D, E, F, H, I, L, M, N, O, Q, and R expose KRS to interest rate risk in that changes in interest rates will adversely affect the fair values of KRS' financial instruments.

In June 2011, the GASB issued Statement No. 64, "Derivative Instruments: Application of Hedge Accounting Termination Provisions, an Amendment of GASB Statement No. 53". The objective of this Statement is to clarify whether an effective hedging relationship continues and hedge accounting should be continued to be applied. Upon the termination of a hedging derivative instrument, hedge accounting should cease and investment income should immediately recognize deferred outflows of resources or deferred inflows of resources. KRS maintains its derivative instruments as investment derivative instruments for all accounting and financial reporting purposes. Therefore, hedge accounting and the related effectiveness testing is not performed.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE D-INVESTMENTS, CONTINUED

Custodial Credit Risk for Deposits - Custodial credit risk for deposits is the risk that in the event of a financial institution failure, KRS' deposits may not be returned. All non-investment related bank balances are held by JP Morgan Chase, which became the depository bank of KRS on July 1, 2011. 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, 2012 and 2011, deposits for KRS pension funds were \$30,925,504 and \$4,795,307, respectively. None of these balances were exposed to custodial credit risk as they were either insured or collateralized at required levels. The increase from prior year is attributable to the implementation of the START project (see Note K for further information regarding START). Employer and member contributions are reported via START and the contributions in fiscal 2012 were being reconciled for qualification and investment purposes as of June 30, 2012. A receivable was recorded for these payrolls as of June 30, 2012. This accounts for the large balance on hand in current year as compared to prior year.

As of June 30, 2012 and 2011, deposits for KRS insurance fund were \$3,130,778 and \$2,020,499, 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, 2012 and 2011, 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.

	<u>2012</u>	<u>2011</u>
<b>Pension Funds</b>		
Foreign Currency	\$ 4,509,853	\$ 8,971,696
<b>Insurance Fund</b>		
Foreign Currency	\$ 1,736,160	\$ 3,703,274

## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining 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.

#### Investment Summary

The following tables present a summary of the investments by type as of June 30, 2012 and 2011:

	2012	2011
<b>Pension Funds</b>		
US Gov't & Agency Fixed Income Securities	\$ 1,789,467,703	\$ 2,474,974,219
US Corporate Fixed Income Securities	1,222,776,472	1,063,223,703
Municipal Debt Securities	79,109,093	78,975,354
Short-Term Investments	375,339,048	1,677,941,341
Equity Securities	4,504,816,279	5,994,749,969
Private Equity Limited Partnerships	1,797,263,220	1,392,099,971
Real Estate	54,047,344	32,251,271
Other*	808,209,209	(1,220,227,180)
	\$ 10,631,028,368	\$ 11,493,988,648

\* As of June 30, 2012 and 2011, this balance consists of:

	2012	2011
Cash Collateral – US Dollars	\$ 21,644,777	\$ 2,570,028
Sukuk***	495,200	94,750
Real Estate		16,500,000
Derivative Offsets:		
US Dollars		(368,603,638)
Equity Futures	(12,467,000)	(868,796,035)
Hedge Fund	817,486,374	
Liabilities:		
Obligation to Return Cash		
Collateral - US Dollars	(18,950,142)	(1,992,285)
	\$ 808,209,209	\$ (1,220,227,180)



KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

\*\*\* The Arabic name for financial certificates, but commonly refers to the Islamic equivalent of bonds; since fixed income interest bearing bonds are not permissible in Islam, Sukuk securities are structured to comply with Islamic Law and its investment principles, which prohibits the charging, or paying, of interest.

	2012	2011
<b>Insurance Fund</b>		
US Gov't & Agency Fixed Income Securities	\$ 596,153,822	\$ 537,586,644
US Corporate Fixed Income Securities	322,100,002	154,320,004
Municipal Debt Securities	15,609,402	14,331,627
Short-Term Investments	185,486,186	792,578,190
Equity Securities	1,368,123,183	1,847,247,012
Private Equity Limited Partnerships	323,438,095	225,938,724
Real Estate	8,100,453	2,522,855
Other**	223,968,702	(557,062,260)
	<u>\$ 3,042,979,845</u>	<u>\$ 3,017,462,796</u>

\*\* As of June 30, 2012 and 2011, this balance consists of:

	2012	2011
Cash Collateral – US Dollars	\$ 5,119,746	\$ 328,313
Real Estate		3,500,000
Derivative Offsets:		
US Dollars		(33,584,200)
Equity Futures	(3,005,800)	(527,274,305)
Hedge Fund	226,403,187	
Liabilities:		
Swaps - US Dollars	(2,858,431)	(32,068)
Obligation to Return Cash	(1,690,000)	
	<u>\$ 223,968,702</u>	<u>\$ (557,062,260)</u>

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining 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 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 and insurance funds debt securities portfolios are 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.
- Fixed income investments will be similar in type to those securities found in the KRS fixed income benchmarks and the characteristics of the KRS fixed income portfolio will be similar to the KRS fixed income benchmarks. The fixed income accounts may include, but are not limited to the following fixed income securities: US Government and Agency bonds; investment grade US corporate credit; investment grade non-US corporate credit; non-investment grade US corporate credit including bonds and bank loans; municipal bonds; non-US sovereign debt; mortgages, including residential mortgage backed securities, commercial mortgage backed securities, and whole loans, asset backed securities, and emerging market debt (EMD), including both sovereign EMD and corporate EMD; and, asset class relevant ETF's.
- 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 Combining Financial Statements, continued

### NOTE D-INVESTMENTS, CONTINUED

The following tables present the KRS pension funds debt ratings as of June 30, 2012 and 2011:

<b>Pension Funds</b>			
<b>Debt Securities Investments at Fair Value</b>			
<b>As of June 30, 2012 and 2011</b>			
<u>Quality Rating</u>		<u>2012</u>	<u>2011</u>
AAA	\$	176,752,688	\$ 91,317,082
AA+		51,817,259	34,390,755
AA		19,865,864	39,864,586
AA-		40,184,012	50,219,759
A+		31,408,066	104,187,245
A		80,076,147	146,999,473
A-		108,297,775	152,567,548
BBB+		57,879,171	64,799,988
BBB		103,233,884	112,518,837
BBB-		81,350,025	56,358,144
BB+		56,241,281	7,166,376
BB		63,795,374	13,417,689
BB-		74,378,918	28,485,658
B+		69,386,148	27,997,068
B		70,846,202	21,129,569
B-		57,149,848	32,172,492
CCC+		27,020,113	6,138,146
CCC		20,493,357	8,838,429
CCC-		5,572,497	1,590,633
CC		720,167	
D		6,361,973	3,394,737
NR		99,054,796	138,644,843
<b>Total Credit Risk Debt Securities</b>		<u>1,301,885,565</u>	<u>1,142,199,057</u>
Government Bonds		607,041,559	508,207,024
Government Mortgage-Backed Securities (GNMA)		248,950,785	725,318,403
Gov't Issued Commercial Mortgage Backed		10,311,861	6,325,040
Government Agencies		32,423,616	95,545,823
Indexed Linked Bonds		890,739,882	1,139,577,929
<b>Total Debt Securities</b>	<b>\$</b>	<u><u>3,091,353,268</u></u>	<u><u>\$ 3,617,173,276</u></u>

At both June 30, 2012 and 2011, the weighted average quality rating of the pension fund debt securities portfolio was AA+. As of June 30, 2012 and 2011, the KRS pension portfolio had \$451,965,878 and \$150,330,797, respectively, in debt securities rated below BBB-. The fair value of securities in the BBB- rating category was \$81,350,025 and \$56,358,144, respectively, as of June 30, 2012 and 2011.

## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

### NOTE D-INVESTMENTS, CONTINUED

The following tables present the KRS insurance fund debt ratings as of June 30, 2012 and 2011:

<b>Insurance Fund</b>			
<b>Debt Securities Investments at Fair Value</b>			
<b>As of June 30, 2012 and 2011</b>			
<u>Quality Rating</u>	<u>2012</u>	<u>2011</u>	
AAA	\$ 99,272,032	\$ 43,946,738	
AA+	8,741,517	2,359,902	
AA	6,899,008	7,044,017	
AA-	7,739,207	7,138,193	
A+	11,301,734	20,243,053	
A	20,358,203	18,381,398	
A-	24,992,822	21,875,607	
BBB+	11,979,181	7,975,298	
BBB	22,934,068	15,146,772	
BBB-	15,084,027	7,256,147	
BB+	11,563,376	202,742	
BB	15,166,400	1,156,866	
BB-	17,353,229	1,916,666	
B+	14,268,206	3,169,797	
B	16,588,386	2,226,250	
B-	14,831,663		
CC	961,988		
CCC	5,522,254		
CCC+	5,323,130	259,375	
CCC-	1,086,041		
D	2,118,411		
NR	3,624,521	8,352,810	
<b>Total Credit Risk Debt Securities</b>	<u>337,709,404</u>	<u>168,651,631</u>	
Government Bonds	164,367,747	94,082,811	
Government Mortgage-Backed Securities (GNMA)	70,007,438	114,153,699	
Gov't Issued Commercial Mortgage Backed	3,156,940	761,681	
Government Agencies	7,506,492	13,394,544	
Indexed Linked Bonds	351,115,205	315,193,909	
<b>Total Debt Securities</b>	<u>\$ 933,863,226</u>	<u>\$ 706,238,275</u>	

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining 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, 2012, the Pension Funds held \$8,003,335, or 0.1%, and the Insurance Fund held \$15,424,404, or 0.5%, 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, 2012, the Pension Funds held \$165,626,504, or 1.6%, 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 Combining 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. Duration measures the sensitivity of the market prices of fixed income securities to changes in the yield curve. Duration is measured using two methodologies: effective and modified duration. Effective duration uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price and makes adjustments for any bond features that would retire the bonds prior to maturity. The modified duration, similar to effective duration, measures the sensitivity of the market prices to changes in the yield curve, but does not assume the securities will be called prior to maturity.

The KRS pension fund benchmarks its fixed income securities portfolio to the Barclays US Universal Index. Prior to June 30, 2011 the KRS pension fund benchmark for its fixed income securities was a combination of the Barclays Aggregate Index and the Barclays TIPS Index. As of June 30, 2012 and 2011, the modified duration of the KRS fixed income benchmark was 5.02 and 6.03, respectively. At the same points in time, the modified duration of the KRS pension fund fixed income securities portfolio was 5.61 and 5.85, respectively.

The KRS insurance fund benchmarks its fixed income securities portfolio to the Barclays US Universal Index. Prior to June 30, 2011 the KRS insurance fund benchmark for its fixed income securities was a combination of the Barclays Aggregate Index and the Barclays TIPS Index. As of June 30, 2012 and 2011, the modified duration of the KRS fixed income benchmark was 5.02 and 7.14, respectively. At the same points in time, the modified duration of the KRS insurance fund fixed income securities portfolio was 5.66 and 6.60, respectively.

KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

NOTE D-INVESTMENTS, CONTINUED

KRS Pension Funds Interest Rate Risk					
	2012		2011		
		Weighted Average Effective Duration		Weighted Average Effective Duration	
Asset Backed Securities	\$ 69,305,698	1.28	\$ 86,628,031	0.64	
Bank Loans	91,076,272	0.14	41,962,680	0.35	
Collateralized Bonds	14,259,490	0.07	6,325,040	(0.22)	
Commercial Mortgage Backed Securities	59,670,935	2.90	88,520,168	4.68	
Corporate Bonds	333,162,366	4.70	735,281,195	4.78	
Corporate Convertible Bonds	16,819,919	4.10			
Government Agencies	32,423,616	5.20	93,545,823	3.97	
Government Bonds	607,041,559	5.70	508,207,024	4.73	
Government Mortgage Backed Securities	248,950,785	1.40	707,971,763	2.91	
Government Issued Commercial Mortgage Backed Securities	10,311,861	3.30	5,211,936	3.22	
Guaranteed Fixed Income			18,882,082	1.37	
Hedge Funds	335,635,038				
Hedge Multi Strategy	3,738,246				
Indexed Linked Government Bonds	890,739,882	8.30	1,139,577,929	3.68	
Municipal Bonds	79,109,093	10.70	78,975,354	10.54	
Non-Government Backed Collateralized Mortgage Obligations	23,690,395	0.93	15,576,827	1.83	
Other Fixed Income	227,154,341				
Short Term Investments	39,719,110				
Short Term Bills/Notes	8,049,462	0.34	90,412,674	0.38	
Sukuk*	495,200	4.20	94,750	0.09	
<b>Total</b>	<b>\$ 3,091,353,268</b>	<b>5.85</b>	<b>\$ 3,617,173,276</b>	<b>3.83</b>	

\* The Arabic name for financial certificates, but commonly refers to the Islamic equivalent of bonds; since fixed income interest bearing bonds are not permissible in Islam, Sukuk securities are structured to comply with Islamic Law and its investment principles, which prohibits the charging, or paying, of interest.

## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

### NOTE D-INVESTMENTS, CONTINUED

KRS Insurance Fund Interest Rate Risk				
	2012	Weighted Average Effective Duration	2011	Weighted Average Effective Duration
Asset Backed Securities	\$ 20,616,445	2.40	\$ 1,000,340	1.73
Bank Loans	19,461,761	3.90	5,808,008	3.58
Collateralized Bonds	5,256,039	0.80		
Commercial Mortgage Backed Securities	12,783,807	3.30	11,977,676	4.42
Corporate Bonds	71,656,715	5.80	69,145,598	5.78
Corporate Convertible Bonds	3,788,169	7.90		
Fixed Income	83,061,859			
Government Agencies	7,506,492	6.40	13,394,544	4.34
Government Bonds	164,367,747	5.80	94,082,811	4.79
Government Mortgage Backed Securities	70,007,438	3.10	114,153,699	4.19
Government Issued Commercial Mortgage Backed Securities	3,156,940	3.60	534,001	3.51
Guaranteed Fixed Income			4,439,819	1.85
Hedge Fund	85,762,072			
Hedge Multi Strategy	1,584,968			
Indexed Linked Government Bonds	351,115,205	8.30	315,193,909	7.78
Municipal/Provincial Bonds	15,609,402	10.00	14,331,627	10.74
Non-Government Backed Collateralized Mortgage Obligations	5,339,625	1.10	2,293,809	3.47
Short Term Investments	11,619,360			
Short Term Bills/Notes	1,169,182	0.50	59,882,434	0.39
<b>Total</b>	<b>\$ 933,863,226</b>	<b>6.60</b>	<b>\$ 706,238,275</b>	<b>5.83</b>



## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining 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, during the fiscal year, KRS employed a third party vendor to dynamically hedge some major currency exposures.

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 originally invested \$12,043,264 of the Pension Funds, and \$4,197,722 of the Insurance Fund, in the Record Currency Management Dynamic Currency Hedging Program (RCM), for a total investment 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 cumulative inception to date 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, as of June 30, 2011. The dynamic currency hedging program previously run by RCM was terminated on November 3, 2011, and is expected to be completely unwound in November 2012.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE D-INVESTMENTS, CONTINUED

The following tables present KRS' exposure to foreign currency risk as of June 30, 2012 and 2011:

	Pension Funds	
	Investments at Fair Value	
	June 30, 2012 and 2011	
	2012	2011
<b>Foreign Equities</b>		
Argentine Peso	\$ 592,995	\$ 1,196,140
Australian Dollar	58,388,163	94,694,698
Brazilian Real	23,932,101	4,278,639
British Pound Sterling	196,765,497	134,777,442
Canadian Dollar	103,163,185	134,071,078
Chilean Peso	2,675,122	
Chinese Yuan	5,183,187	521,787
Columbian Peso	3,148,357	1,222,930
Czech Koruna	3,158,280	1,658,886
Danish Krone	8,606,995	16,152,506
Euro	312,248,180	433,029,933
Hong Kong Dollar	90,614,411	68,788,630
Hungarian Forint	1,251,857	
Indian Rupee	3,536,235	
Indonesian Rupiah	14,715,167	2,243,714
Israeli Shekel	1,703,453	
Japanese Yen	232,665,797	265,405,175
Malaysian Ringgit	3,068,235	2,426,541
Mexican Peso	18,202,265	3,661,558
New Taiwan Dollar	25,479,684	5,254,844
New Zealand Dollar	1,013,380	1,338,143
Norwegian Krone	4,046,964	11,346,709
Peruvian Nuevo Sol	1,216,727	
Philippine Peso	6,438,447	138,885
Polish Zloty	4,802,910	
Russian Ruble	7,570,244	1,036,961
Singapore Dollar	22,349,886	22,053,536
South African Rand	23,545,955	2,758,884
South Korean Won	70,999,258	4,512,110
Swedish Krona	27,191,886	23,544,658
Swiss Franc	81,004,268	95,068,382
Thai Bhat	9,159,880	
Turkish Lira	6,233,784	
International Equity Mutual Fund (various currencies)		920,141,284
<b>Total Securities subject to Foreign Currency Risk</b>	<b>1,374,672,755</b>	<b>2,251,324,053</b>
USD (securities held by International Investment Managers)	9,256,355,650	1,659,713,681
<b>Total International Investment Securities</b>	<b>\$ 10,631,028,405</b>	<b>\$ 3,911,037,734</b>

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE D-INVESTMENTS, CONTINUED

	Insurance Fund	
	Investments at Fair Value	
	June 30, 2012 and 2011	
	2012	2011
<b>Foreign Equities</b>		
Australian Dollar	\$ 20,374,499	\$ 37,342,712
Brazilian Real	6,775,870	607,112
British Pound Sterling	69,217,342	50,278,435
Canadian Dollar	35,948,462	53,058,136
Chilean Peso	786,711	
Chinese Yuan	1,298,990	
Columbian Peso	796,126	
Czech Koruna	990,353	427,698
Danish Krone	2,959,795	5,937,869
Euro	105,768,977	167,585,939
Hong Kong Dollar	31,672,609	24,192,383
Hungarian Forint	315,114	71
Indian Rupee	882,340	
Indonesian Rupiah	4,828,536	2,832
Israeli Shekel	429,103	
Japanese Yen	79,821,116	104,116,859
Malaysian Ringgit	740,285	
Mexican Peso	4,224,645	370,341
New Taiwan Dollar	8,671,587	1,351,967
New Zealand Dollar	296,011	556,742
Norwegian Krone	1,355,472	4,589,032
Peruvian Nuevo Sol	304,965	
Philippine Peso	1,699,557	
Polish Zloty	1,263,786	
Russian Ruble	1,762,447	
Singapore Dollar	7,014,550	8,739,442
South African Rand	7,916,313	307,167
South Korean Won	23,790,001	1,165,059
Swedish Krona	9,210,394	8,758,300
Swiss Franc	28,469,252	36,824,057
Thai Bhat	3,108,109	
Turkish Lira	2,072,912	
International Equity Mutual Fund (various currencies)		199,878,520
<b>Total Securities subject to Foreign Currency Risk</b>	464,766,229	706,090,673
USD (securities held by International Investment Managers)	2,578,213,716	524,261,020
<b>Total International Investment Securities</b>	\$ 3,042,979,945	\$ 1,230,351,693

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining 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 an initial fair value of 102 or 105 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, 2012, 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. Deutsche Bank invests cash collateral as permitted by state statute and Board policy. The agent 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 Deutsche Bank, 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.

Claims against the Board 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.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

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

Claims for job-related illnesses or injuries to employees are insured by the state's self-insured workers' compensation program. Payments approved by the program are not subject to maximum limitations. A claimant may receive reimbursement for all medical expenses related to the illness or injury and up to sixty-six and two-third 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 is subject to income tax on any unrelated business income; however, KRS had no unrelated business income in fiscal 2012.

#### 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 who began participating prior to September 1, 2008, contributed 5% of creditable compensation for the periods ended June 30, 2012, 2011, and 2010. Plan members who began participating on, or after, September 1, 2008, contributed 6% of creditable compensation for the periods ended June 30, 2012, 2011, and 2010. KRS contributed 19.82%, 16.98%, and 11.61% of covered payroll for the periods ended June 30, 2012, 2011, and 2010, respectively.

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Covered Payroll	\$ 13,784,847	\$ 13,444,315	\$ 13,383,859
Required Employer Contributions	2,726,780	2,282,864	1,553,865
Employer Percentage Contributed	100%	100%	100%

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE J-EQUIPMENT

Equipment consists of the following:

	June 30	
	2012	2011
Equipment, at cost	\$ 6,753,648	\$ 6,971,185
Less Accumulated Depreciation	<u>(2,805,034)</u>	<u>(2,987,098)</u>
	<u>\$ 3,948,614</u>	<u>\$ 3,984,087</u>

Depreciation expense for the fiscal years ended June 30, 2012 and 2011 amounted to \$68,471 and \$62,203, respectively. The decrease in equipment at cost is due to some assets being fully depreciated as of June 30, 2012.

#### NOTE K-INTANGIBLE ASSETS

The provisions of 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 accordance with 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	
	2012	2011
Software, at cost	\$ 12,724,117	\$ 7,424,611
Less Accumulated Amortization	<u>(2,893,011)</u>	<u>(1,682,261)</u>
	<u>\$ 9,831,106</u>	<u>\$ 5,742,350</u>

Amortization expense for the fiscal years ended June 30, 2012 and 2011 amounted to \$1,210,750 and \$688,473, respectively. The increase in software at cost is due to the capitalization of the final costs associated with the START project.

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.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE L-ACTUARIAL VALUATION

The provisions of 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 accordance with 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, 2012	June 30, 2012
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	25 Years	25 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%-17.0%	4.5%-21.0%
Cost of Living Adjustment	None	None
<i>**Includes Wage Inflation at</i>	4.5%	4.5%

#### INSURANCE FUND\*\*\*

	Non-Hazardous	Hazardous
Valuation Date	June 30, 2012	June 30, 2012
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	25 Years	25 Years
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market

## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

### NOTE L-ACTUARIAL VALUATION, CONTINUED

	Non-Hazardous	Hazardous
Medical Trend Assumption:		
Pre-Medicare	9.5%-5.0%	9.5%-5.0%
Post-Medicare	7.5%-5.0%	7.5%-5.0%
Year of Ultimate Trend	2019	2019
Actuarial Assumptions:		
Investment Rate of Return*	4.5% and 7.75%**	4.5% and 7.75%
*Includes Price Inflation at	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 since the actual rate contributed by the employers is less than the actuarially recommended rate.

\*\*\*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.

KRS Pension and Insurance Funds had the following Unfunded Actuarial Accrued Liabilities as of June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
<b>Pension Funds:</b>		
Kentucky Employees Retirement System (Non-Hazardous)	\$ 8,259,731,398	\$ 7,455,155,945
Kentucky Employees Retirement System (Hazardous)	255,473,161	210,544,939
County Employees Retirement System (Non-Hazardous)	3,592,332,096	3,288,473,842
County Employees Retirement System (Hazardous)	1,262,612,750	1,079,495,659
State Police Retirement System	<u>387,897,090</u>	<u>348,798,770</u>
Total Pension Funds	<u>13,758,046,495</u>	<u>12,382,469,155</u>
<b>Insurance Fund:</b>		
Kentucky Employees Retirement System (Non-Hazardous)	2,679,249,646	3,828,469,191
Kentucky Employees Retirement System (Hazardous)	39,018,458	177,097,152
County Employees Retirement System (Non-Hazardous)	857,917,437	1,640,522,412
County Employees Retirement System (Hazardous)	535,802,215	876,912,481
State Police Retirement System	<u>209,531,710</u>	<u>314,740,474</u>
Total Insurance Fund	<u>4,321,519,466</u>	<u>6,837,741,710</u>
<b>Total Unfunded Actuarial Accrued Liability</b>	<u>\$ 18,079,565,961</u>	<u>\$ 19,220,210,865</u>



## KENTUCKY RETIREMENT SYSTEMS

Notes to the Combining Financial Statements, continued

### NOTE L-ACTUARIAL VALUATION, CONTINUED

The following is the Schedule of Funding Progress for the fiscal year ended June 30, 2012:

	<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>
<b>Pension Funds:</b>					
Kentucky Employees Retirement System (Non-Hazardous)	\$ 3,101,316,738	\$ 11,361,048,136	27.3	\$ 1,644,896,681	502.1
Kentucky Employees Retirement System (Hazardous)	497,226,296	752,699,457	66.1	131,976,754	193.6
County Employees Retirement System (Non-Hazardous)	5,547,235,599	9,139,567,695	60.7	2,236,546,345	160.6
County Employees Retirement System (Hazardous)	1,747,379,297	3,009,992,047	58.1	464,228,923	272.0
State Police Retirement System	<u>259,791,575</u>	<u>647,688,665</u>	<u>40.1</u>	<u>48,372,506</u>	<u>801.9</u>
Total Pension Funds	<u>11,152,949,505</u>	<u>24,910,996,000</u>	<u>44.8</u>	<u>4,526,021,209</u>	<u>304.0</u>
<b>Insurance Fund:</b>					
Kentucky Employees Retirement System (Non-Hazardous)	446,080,511	3,125,330,157	14.3	1,644,896,681	162.9
Kentucky Employees Retirement System (Hazardous)	345,573,948	384,592,406	89.9	131,976,754	29.6
County Employees Retirement System (Non-Hazardous)	1,512,853,851	2,370,771,288	63.8	2,236,546,345	38.4
County Employees Retirement System (Hazardous)	829,040,842	1,364,843,057	60.7	464,228,923	115.4
State Police Retirement System	<u>124,372,072</u>	<u>333,903,782</u>	<u>37.2</u>	<u>48,372,506</u>	<u>433.2</u>
Total Insurance Fund	<u>3,257,921,224</u>	<u>7,579,440,690</u>	<u>42.9</u>	<u>4,526,021,209</u>	<u>95.5</u>
Totals	<u>\$ 14,410,870,729</u>	<u>\$ 32,490,436,690</u>	<u>44.4</u>	<u>\$ 9,052,042,418</u>	<u>199.7</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 Combining Financial Statements, continued

#### NOTE M-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) for the payment of health insurance benefits. 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 for the payment of health insurance benefits. 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 2012 were established in the 2010-2012 Executive Branch Budget (House Bill 1) during the 2010 Extraordinary Session of the Kentucky General Assembly. Employer contribution rates for CERS for fiscal 2012 were adopted by the KRS Board of Trustees based on the actuarially recommended rates. The Employer contribution rates were established as follows (effective July 1, 2011) for fiscal 2012:

KERS-Non Hazardous	19.82%
KERS-Hazardous	28.98%
CERS-Non Hazardous	18.96%
CERS-Hazardous	35.76%
SPRS	52.13%

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE M-HOUSE BILL 1 PENSION REFORM, CONTINUED

Although the majority of changes enacted in House Bill 1 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 are set by statute 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 must assume the earliest date a member can retire with an unreduced benefit, and must also assume a 1.5% COLA will be enacted. This change results in an increased service purchase cost for any purchase calculated on, or after, September 1, 2008. This change also affects the cost billed to employers for sick leave when an employee retires.

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

Kentucky Revised Statute 61.637 was modified significantly by House Bill 1. Specifically, a member who retired and was 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 N-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 Northern Trust. As of June 30, 2012 and 2011, the Insolvency Account amounted to \$100,691 and \$100,620, respectively.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE O-HOUSE BILL 300 PENSION REFORM

House Bill 300 was signed by the Governor on April 11, 2012. The Bill makes changes/additions to information and definitions regarding placement agents, audits to be performed on KRS by the Kentucky Auditor of Public Accounts, terms of service of Trustees of the Board, terms of service of Board officers (Chair and Vice Chair), among other changes.

#### 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, 2012 and 2011, the reimbursement totaled \$6,349,929 and \$4,041,974, 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 was \$5,113,511, and the total employee contribution owed was \$2,083,310, for a total of \$7,196,821. These amounts were received on July 27, 2010.

KRS also calculated the impact on final compensation caused by the retroactive benefits paid to those firefighters who have already retired. KRS was required to pay retroactive benefit payments totaling \$6,221,219, reflecting additional benefits due to the increase in final compensation. 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 Louisville/Jefferson County Metro Government, as calculated by KRS' actuaries, amounted to \$12,020,731. Therefore, the total amount due KRS was \$19,217,552. As stated earlier, \$7,196,821 was received on July 27, 2010.

On July 2, 2012, KRS received an additional \$7,000,000, for interest owed, which by settlement extinguished the liability to KRS.

## KENTUCKY RETIREMENT SYSTEMS

### Notes to the Combining Financial Statements, continued

#### NOTE R-RECIPROCALITY AGREEMENT

KRS has a reciprocity agreement with Kentucky Teachers' Retirement System (KTRS) for the payment of insurance benefits for those members who have creditable service in both systems. As of June 30, 2012, KTRS has estimated a receivable due from KRS in the amount of \$3.8 million. However, KRS has chosen not to record a payable or receivable under the reciprocity agreement since, in KRS' view, it cannot be reasonably estimated as of June 30, 2012.

#### NOTE S-RESTATEMENT OF PRIOR YEAR FINANCIAL STATEMENTS

The Pension and Insurance Funds' Net Assets as of June 30, 2011, and the increase in the Pension and Insurance Funds' Net Assets for the fiscal year then ended, have been restated to correct accrued contributions at June 30, 2011. See detail noted below. The net effect of these corrections for reporting purposes were decreases of \$62,843,424 and \$48,449,690 in pension and insurance contributions, respectively, for the fiscal year ended June 30, 2011, and a corresponding decrease in the pension and insurance funds' net assets at June 30, 2011, respectively. The restatement resulted from the double posting of an accrual of contributions in fiscal 2011.

	<u>As Previously Reported</u>	<u>As Restated</u>
<b>Pension Funds:</b>		
Contributions Receivable	\$138,808	\$75,695
Plan Net Assets Held in Trust for Pension Benefits	\$11,680,563	\$11,617,720
Members' Contributions	\$326,842	\$306,033
Employers' Contributions	\$548,126	\$506,592
Health Insurance Contributions	\$7,086	\$6,586
Net Increase in Plan Assets	\$1,140,124	\$1,077,281
<b>Insurance Fund:</b>		
Contributions Receivable	\$71,726	\$23,276
Plan Net Assets Held in Trust for Insurance Benefits	\$3,096,788	\$3,048,338
Employers' Contributions	\$435,975	\$387,525
Net Increase in Plan Assets	\$670,803	\$622,353

#### NOTE T-SUBSEQUENT EVENTS

Management has evaluated the period from June 30, 2012, to December 5, 2012, (the date the financial statements were available to be issued) for items requiring recognition or disclosure in the financial statements. Except as disclosed in Notes B and Q, there were no events occurring during the evaluation period that require disclosure, and there were no events that require recognition in the combining financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules of Funding Progress

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)-PENSION FUNDS

	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age Normal	Unfunded AAL (UAAL)	Percent Funded	Covered Payroll	UAAL as a % of Covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)**	[(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 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
June 30, 2012	3,101,316,738	11,361,048,136	8,259,731,398	27.3	1,644,896,681	502.1
<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
June 30, 2012	497,226,296	752,699,457	255,473,161	66.1	131,976,754	193.6
<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
June 30, 2012	3,598,543,034	12,113,747,593	8,515,204,559	29.7	1,776,873,435	479.2

\*\*Actuarially Computed

See Independent Auditors' Report.

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules 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
June 30, 2012	5,547,235,599	9,139,567,695	3,592,332,096	60.7	2,236,546,345	160.6
<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
June 30, 2012	1,747,379,297	3,009,992,047	1,262,612,750	58.1	464,228,923	272.0
<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
June 30, 2012	7,294,614,896	12,149,559,743	4,854,944,847	60.0	2,700,775,268	179.8

\*\*Actuarially Computed

See Independent Auditors' Report.



KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules of Funding Progress

STATE POLICE RETIREMENT SYSTEM (SPRS)-PENSION FUNDS

Year Ended	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	\$ 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
June 30, 2012	259,791,575	647,688,665	387,897,090	40.1	48,372,506	801.9

\*\*Actuarially Computed

See Independent Auditors' Report.

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules of Funding Progress

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)-INSURANCE FUND

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)**	UAAL as a % of Covered Payroll [(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 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
June 30, 2012	446,080,511	3,125,330,157	2,679,249,646	14.3	1,644,896,681	162.9
<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
June 30, 2012	345,573,948	384,592,406	39,018,458	89.9	131,976,754	29.6
<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
June 30, 2012	791,654,459	3,509,922,563	2,718,268,104	22.6	1,776,873,435	153.0

\*\*Actuarially Computed

See Independent Auditors' Report.

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules of Funding Progress

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)-INSURANCE FUND

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)**	UAAL as a % of Covered Payroll [(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 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
June 30, 2012	1,512,853,851	2,370,771,288	857,917,437	63.8	2,236,546,345	38.4
<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
June 30, 2012	829,040,842	1,364,843,057	535,802,215	60.7	464,228,923	115.4
<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
June 30, 2012	2,341,894,693	3,735,614,345	1,393,719,652	62.7	2,700,775,268	51.6

\*\*Actuarially Computed

See Independent Auditors' Report.

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules 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
June 30, 2012	124,372,072	333,903,782	209,531,710	37.2	48,372,506	433.2

\*\*Actuarially Computed

See Independent Auditors' Report.

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules 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
June 30, 2012	441,094,470	214,786,132		48.7

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
June 30, 2012	297,904,224	156,057,216		52.4

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
June 30, 2012	738,998,694	370,843,348		50.2

See Independent Auditors' Report.

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules of Contributions From Employers and Other Contributing Entities

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)

HAZARDOUS EMPLOYEES

Year Ended	Pension			
	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
June 30, 2012	20,264,754	20,808,540		102.7

Year Ended	Insurance			
	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
June 30, 2012	28,326,206	24,538,087		86.6

Year Ended	Total			
	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
June 30, 2012	48,590,960	45,346,627		93.3

**KENTUCKY RETIREMENT SYSTEMS**

Required Supplementary Information

Schedules 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
June 30, 2012	261,764,019	275,736,191			105.3

  

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	123,852,611		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
June 30, 2012	214,421,008	171,924,836			80.2

  

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	303,137,162		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
June 30, 2012	476,185,027	447,661,027			94.0

KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules 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	78,795,602	85,078,181		108.0
June 30, 2012	83,588,958	89,329,217		106.9

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
June 30, 2012	110,762,577	92,563,664		83.6

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
June 30, 2012	194,351,535	181,892,881		93.6



KENTUCKY RETIREMENT SYSTEMS

Required Supplementary Information

Schedules 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
June 30, 2012	20,497,924	15,361,781		74.9

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	8,369,428	273,684	28.5
June 30, 2011	25,772,574	11,050,964		42.9
June 30, 2012	28,246,786	11,960,468		42.3

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	17,858,827	273,684	37.5
June 30, 2011	44,235,946	23,708,189		53.6
June 30, 2012	48,744,710	27,322,249		56.0

ADDITIONAL SUPPORTING SCHEDULES

# KENTUCKY RETIREMENT SYSTEMS

## Schedule of Administrative Expenses

For the Fiscal Years Ended June 30, 2012 and 2011

	2012	2011
	(Dollars in thousands)	
<b>Personnel</b>		
Salaries and Per Diem	\$ 14,316	\$ 13,889
Fringe Benefits	5,561	5,179
Tuition Assistance	31	23
<b>Total Personnel</b>	19,908	19,091
<b>Contractual</b>		
Actuarial Services	297	270
Audit Services	30	111
Human Resources	40	
Legal Counsel	806	231
Medical Review Services	229	306
Miscellaneous	1,008	1,353
<b>Total Contractual</b>	2,410	2,271
<b>Communication</b>		
Printing	299	286
Telephone	132	118
Postage	525	593
Travel	182	118
<b>Total Communication</b>	1,138	1,115
<b>Internal Audit</b>		
Travel/Conferences	1	
Dues/Subscriptions	2	
Miscellaneous	1	
<b>Total Internal Audit</b>	4	
<b>Investments (Pension Fund)</b>		
Travel/Conferences	41	
Dues/Subscriptions	26	
Computer	149	
Contractual	858	
Miscellaneous	15	
Legal	265	
<b>Total Investments</b>	1,354	
<b>Rentals</b>		
Office Space	1,144	1,125
Equipment	91	90
<b>Total Rentals</b>	1,235	1,215
<b>Miscellaneous</b>		
Utilities	201	217
Supplies	140	176
Insurance	76	78
Maintenance	40	5
<b>Total Miscellaneous</b>	457	476

## KENTUCKY RETIREMENT SYSTEMS

### Schedule of Administrative Expenses, continued

For the Fiscal Years Ended June 30, 2012 and 2011

	2012	2011
	(Dollars in thousands)	
Depreciation/Amortization	1,279	750
<b>Total Pension Fund Administrative Expense</b>	<b>27,785</b>	<b>24,918</b>
<b>Investment Expenses (Insurance Fund)</b>		
Investment Consultant	246	
Investment Related Travel	9	
Dues & Subscriptions	7	
Conferences	3	
Miscellaneous	4	
Software	43	
Legal Counsel	76	
	388	
<b>Healthcare Fees</b>	<b>11,584</b>	<b>10,412</b>
<b>Total Insurance Fund Administrative Expense</b>	<b>11,972</b>	<b>10,412</b>
<b>Total Administrative Expenses</b>	<b>\$ 39,757</b>	<b>\$ 35,330</b>

Note: In fiscal 2012, Administrative Expenses include the Healthcare Fees and Investment Expenses which are paid through the Pension Funds and reimbursed by the Insurance Fund.

## KENTUCKY RETIREMENT SYSTEMS

### Schedule of Direct Investment Expenses

For the Fiscal Years Ended June 30, 2012 and 2011

	2012	2011
	(Dollars in thousands)	
<b>PENSION FUNDS</b>		
<b>Security Lending Fees</b>		
Broker (Income) Rebates	\$ (261)	\$ 2,277
Lending Agent Fees	229	1,162
<b>Total Security Lending</b>	(32)	3,439
<b>Common Stock Commissions</b>	4,259	7,643
<b>Contractual Services</b>		
Investment Management	33,471	47,265
Security Custody/Investment Consultant	858*	1,079
Investment Related Travel	31*	27
Software	149*	148
Dues & Subscriptions	26*	
Conferences	10*	
Miscellaneous	15*	113
Legal Counsel	265*	943
<b>Total Contractual Services</b>	1,354	2,310
	34,825	49,575
<b>INSURANCE FUND</b>		
<b>Security Lending Fees</b>		
Broker (Income) Rebates	(153)	240
Lending Agent Fees	68	325
<b>Total Security Lending</b>	(85)	565
<b>Common Stock Commissions</b>	1,275	1,236
<b>Contractual Services</b>		
Investment Management	6,754	7,323
Security Custody/Investment Consultant	246*	340
Investment Related Travel	9*	6
Dues & Subscriptions	7*	
Conferences	3*	
Miscellaneous	4*	26
Software	43*	34
Legal Counsel	76*	23
<b>Total Contractual Services</b>	388	429
	7,142	7,752
<b>Total Investment Expenses</b>	\$ 47,384	\$ 70,210

\* In fiscal 2012, investment travel, software, dues, etc. were funded through the Administrative Expense Account; see pages 70-71.

See Independent Auditors' Report.

KENTUCKY RETIREMENT SYSTEMS

Schedule of Professional Consultant Fees

For the Fiscal Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
	(Dollars in thousands)	
Actuarial Services	\$ 297	\$ 270
Medical Review Services	229	306
Audit Services	30	111
Legal Counsel	806	231
Compliance	98	771
Workflow	28	209
Healthcare	699	113
Banking	66	55
Human Resources	40	
Miscellaneous	<u>117</u>	<u>205</u>
Total	<u>\$ 2,410</u>	<u>\$ 2,271</u>

DEAN || DORTON || ALLEN || FORD<sub>LLP</sub>

**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 combining financial statements of Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of and for the fiscal year ended June 30, 2012, and have issued our report thereon dated December 5, 2012. 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

Management of Kentucky Retirement Systems is responsible for establishing and maintaining effective 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 combining 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' combining 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 and use of the Board of Trustees, 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 Dotson Allen Ford, PLLC*

December 5, 2012  
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*.