REPORT OF THE AUDIT OF THE KENTUCKY RETIREMENT SYSTEMS

For The Fiscal Year Ended
June 30, 2013

ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS
www.auditor.ky.gov

209 ST. CLAIR STREET
FRANKFORT, KY 40601-1817
TELEPHONE (502) 564-5841
FACSIMILE (502) 564-2912

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ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

Board of Trustees
Kentucky Retirement Systems
Frankfort, Kentucky

Independent Auditor's Report

Report on the Financial Statements

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 year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Kentucky Retirement Systems basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Kentucky Retirement Systems' management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Kentucky Retirement Systems' preparation and fair presentation of the financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

209 St. Clair Street
Frankfort, KY 40601-1817
Telephone 502.564.5841
Facsimile 502.564.2912
www.auditor.ky.gov

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We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net position of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of June 30, 2013 and the changes in plan net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matters

Reporting Entity

As discussed in Note A, the financial statements present only the Kentucky Retirement Systems, and are not intended to present fairly the financial position of the Commonwealth of Kentucky, or the results of its operations in conformity with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

The combining financial statements of Kentucky Retirement Systems for the year ended June 30, 2012 were audited by other auditors whose report dated December 5, 2012, stated that the plan net assets (position) as of June 30, 2012 and changes in plan net assets (position) for the year then ended were in conformity with accounting principles generally accepted in the United States of America. The combining financial statements for the year then ended (not presented herein), were audited by other auditors whose report, dated December 5, 2012, expressed an unqualified opinion on those statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis (pages 7 through 12) and the Schedules of Funding Progress and Schedules of Contributions from Employers and Contributing Entities (pages 69 through 79) 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 the financial reporting for placing the basic financial statements in an appropriate operational, economical, 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

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knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures did not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Kentucky Retirement System's basic financial statements. The additional supporting schedules (pages 83 through 86) are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supporting schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit 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 supporting schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 5, 2013 on our consideration of the Kentucky Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering KRS' internal control over financial reporting and compliance.

Respectfully submitted,

Adam H. Edelen
Auditor of Public Accounts

December 5, 2013

MANAGEMENT’S DISCUSSION AND ANALYSIS

KENTUCKY RETIREMENT SYSTEMS
MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2013. Please read it in conjunction with the financial statements, which begin on page 15.

Financial Highlights-Pension Funds

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

- The combined net position of all pension funds administered by Kentucky Retirement Systems increased by $399.1 million during fiscal 2013.

- Member and Employer contributions reported for fiscal 2013, totaled $1,027.2 million compared to $872.8 million in fiscal 2012. This increase is due to an increase in the employer contribution rates and the collection of additional health insurance contributions.

- The net appreciation in the fair value of investments was $890.6 million for the fiscal year ended June 30, 2013 compared to net depreciation of $261.2 million for the prior fiscal year. Included in this net appreciation in fiscal 2013 were realized gains on sales of investments of $464.6 million.

- Interest, dividend and net securities lending income was $291.3 million compared to $270.3 million in fiscal 2012.

- Pension benefits paid to retirees and beneficiaries totaled $1,706.2 million compared to $1,649.2 million in fiscal 2012. Refund of contributions paid to former members upon termination of employment totaled $32.2 million compared to $31.0 million in fiscal 2012.

- Administrative expense totaled $30.5 million compared to $27.8 million in the prior fiscal year. Certain START Project costs were capitalized in fiscal 2013 between fixed assets and intangible assets, as appropriate.

- The Administrative Expense Budget includes expenses for health care fees, investments, and internal audit as separate line items.

- The member health insurance contribution totaled $9.1 million, for the fiscal year ended June 30, 2013, compared to $7.3 million in the prior fiscal year.

Financial Highlights-Insurance Fund

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

- The combined net position of the insurance fund administered by Kentucky Retirement Systems increased by $432.5 million during fiscal 2013.

- Premiums received from retirees who participated in the Medicare eligible self-funded plan totaled $26.3 million, compared to $28.4 million in fiscal 2012. 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 $447.3 million were received compared to $436.2 million in fiscal 2012. This increase is due to an increase in the insurance contribution rate.

- The Employer Group Waiver Plan receipts from the Centers for Medicare and Medicaid Services (CMS) subsidies totaled $11.2 million compared to $17.8 million in fiscal 2012. Changes in receipts depend upon the fluctuation of membership in the Plan.

- The net appreciation in the fair value of investments was $232.9 million compared to net depreciation of $118.7 million for the prior fiscal year. Included in this net appreciation in fiscal 2013 were realized gains on sales of investments of $108.4 million.

- Interest, dividend and net securities lending income was $90.4 million compared to $71.4 million in fiscal 2012.

- Premiums paid by the fund for hospital and medical insurance coverage (under age 65) totaled $283.1 million. Payments for the self-funded healthcare reimbursements (over age 65) totaled $78.8 million. The total of insurance premiums paid plus self-funded reimbursements was $361.9 million for fiscal 2013. Insurance premiums paid plus self-funded healthcare reimbursements for the prior plan year totaled $380.4 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 became effective January 1, 2013.

- 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, 2013, totaled $100,001.

- The reimbursement of retired-reemployed health insurance totaled $5.8 million for the fiscal year ended June 30, 2013, compared to $6.3 million in the prior fiscal year.

KENTUCKY RETIREMENT SYSTEMS
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

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 Combining Statement of Plan Net Position for the Pension Funds, on page 15, and the Combining Statement of Plan Net Position for the Insurance Fund, on page 18, provides a snapshot of the financial position of each of the three systems at June 30, 2013. The Combining Statement of Changes in Plan Net Position for the Pension Funds, on pages 16-17, and the Combining Statement of Changes in Plan Net Position for the Insurance Fund, on pages 19-20, summarizes the additions and deductions that occurred for each of the three systems during fiscal 2013.

The Schedules of Funding Progress, on pages 69, 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 75 to 79, 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 as a Whole

Kentucky Retirement Systems' combined net position increased, during the fiscal year ended June 30, 2013, by $831.6 million from $13,843.4 million to $14,675.0 million. Net position for the prior fiscal year decreased by $822.6 million. The increase in net position for the plan year ended June 30, 2013 is primarily attributable to a net appreciation in the fair value of investments, an increase in member contributions and a decrease in health care costs. The analysis below focuses on net position (Table 1) and changes in net position (Table 2) of Kentucky Retirement Systems' Pension and Insurance Funds.

Table 1
Net Position
(In Millions)

	Pension Funds - June 30,			Insurance Fund - June 30,			Total - June 30,		
	2013	2012	2011	2013	2012	2011	2013	2012	2011
Cash & Invest.	$ 12,431.7	$ 11,922.7	$ 13,217.3	$ 3,992.1	$ 3,243.5	$ 3,458.4	$ 16,423.8	$ 15,166.2	$ 16,675.7
Receivables	136.1	145.6	115.3	49.1	71.9	32.3	185.2	217.5	147.6
Equip/Int Assets, net of dep/amort.	16.1	13.8	9.7				16.1	13.8	9.7
Total Assets	12,583.9	12,082.1	13,342.3	4,041.2	3,315.4	3,490.7	16,625.1	15,397.5	16,833.0
Total Liabilities	(1,430.8)	(1,328.1)	(1,724.6)	(519.3)	(226.0)	(442.4)	(1,950.1)	(1,554.1)	(2,167.0)
Net Position	$ 11,153.1	$ 10,754.0	$ 11,617.7	$ 3,521.9	$ 3,089.4	$ 3,048.3	$ 14,675.0	$ 13,843.4	$ 14,666.0

KENTUCKY RETIREMENT SYSTEMS
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Kentucky Retirement Systems as a Whole (Continued)

Table 2
Changes in Net Position
(In Millions)

	Pension Funds - June 30,			Insurance Fund - June 30,			Total - June 30,		
	2013	2012	2011	2013	2012	2011	2013	2012	2011
Additions:									
Member Cont.	$ 276.3	$ 274.1	$ 306.0	$	$	$	$ 276.3	$ 274.1	$ 306.0
Employer Cont.	741.8	591.4	506.6	447.3	436.2	387.5	1,189.1	1,027.6	894.1
Heath Ins. Cont.	9.1	7.3	6.6				9.1	7.3	6.6
Premiums Rec'd				26.3	28.4	31.0	26.3	28.4	31.0
Retired Remp Ins.				5.8	6.3	4.0	5.8	6.3	4.0
Medicare Subsidy				11.2	17.8	22.1	11.2	17.8	22.1
Invest. Inc. (net)	1,140.8	(28.5)	1,902.2	313.6	(55.3)	561.2	1,454.4	(83.8)	2,463.4
Total Additions	2,168.0	844.3	2,721.4	804.2	433.4	1,005.8	2,972.2	1,277.7	3,727.2
Deductions:									
Benefit payments	1,706.2	1,649.2	1,591.5				1,706.2	1,649.2	1,591.5
Refunds	32.2	31.0	27.5				32.2	31.0	27.5
Administrative Ex.	30.5	27.8	24.9	9.8	11.9	10.4	40.3	39.7	35.3
Capital Projects Ex.			0.2						0.2
Healthcare Costs				361.9	380.4	373.1	361.9	380.4	373.1
Total Deductions	1,768.9	1,708.0	1,644.1	371.7	392.3	383.5	2,140.6	2,100.3	2,027.6
Inc. (Decrease) in Net Position	$ 399.1	$ (863.7)	$ 1,077.3	$ 432.5	$ 41.1	$ 622.3	$ 831.6	$ (822.6)	$ 1,699.6

Net position of the pension funds increased by $399.1 million ($11,153.1 million compared to $10,754.0 million). All of these assets are restricted in use to provide monthly retirement allowances to members who contributed to the pension funds as employees and their beneficiaries. Net position of the insurance fund increased by $432.5 million ($3,521.9 million compared to $3,089.4 million). All of these assets are restricted in use to provide hospital and medical insurance benefits to members of the pension funds who receive a monthly retirement allowance. The increase in net position is primarily attributable to the increase in employer contribution rates for insurance.

Pension Fund Activities

Member contributions increased by $2.2 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.

Employer contributions increased by $150.4 million due to the increase in employer contribution rate applied to covered payroll.

Pension Fund Activities (Continued)

Net investment income increased by $1,170 million. This is illustrated in Table 3. The pension funds experienced an increase in income primarily due to the gain on the sale of investments.

Table 3	**In Millions - June 30,**		
Investment (Loss) Income - Pension	2013	2012	2011
(Decrease) increase in fair value of investments	$ 426	$ (238)	$ 707
Investment income net of investment expense	250	232	244
(Loss) gain on sale of investments	465	(23)	951
Net investment (loss) income	$ 1,141	$ (29)	$ 1,902

Pension fund deductions increased by $60.9 million caused principally by an increase of $57 million in benefit payments**.** Refunds of member contributions increased by $1.2 million and administrative expenses increased by $2.7 million. Certain START Project costs were capitalized in fiscal 2013 between fixed assets and intangible assets, as appropriate.

Insurance Fund Activities

Employer contributions paid into the insurance fund increased by $11.1 million over the prior fiscal year. This increase is a result of the increase in the employer contribution rate applied to covered payroll.

Net investment income increased $369.0 million. This increase in net investment income is due primarily to the increase in the fair value of investments. This is illustrated in Table 4 as follows:

Table 4	**In Millions - June 30,**		
Investment (Loss) Income -Insurance	2013	2012	2011
(Decrease) increase in fair value of investments	$ 125	$ (21)	$ 169
Investment income net of investment expense	81	63	44
(Loss) gain on sale of investments	108	(97)	348
Net investment (loss) income	$ 314	$ (55)	$ 561

Insurance fund deductions decreased by $20.6 million due to the cessation of the self funding plan.

Historical Trends

Accounting standards require that the Statement of Net Position 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 69-74. 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 $744.9 million for a total unfunded amount of $14,502.9 million for the fiscal year ended June 30, 2013, compared to an unfunded amount of $13,758.0 million for the fiscal year ended June 30, 2012. 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.

The insurance plan's unfunded actuarial accrued liability for the plan year ended June 30, 2013, decreased to $3,092.1 million from $4,321.5 million for the plan year ended June 30, 2012. This is a decrease in the unfunded actuarial accrued liability of $1,229.4 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 75-79. 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.

FINANCIAL STATEMENTS

KENTUCKY RETIREMENT SYSTEMS
COMBINING STATEMENT OF PLAN NET POSITION-PENSION FUNDS
As of June 30, 2013 (with Comparative Totals As Of June 30, 2012)
(Dollars in Thousands)

	2013						Restated 2012
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
ASSETS							
Cash and Short-Term Investments							
Cash	$ 211	$ 2,308	$ 399	$ 2,631	$ 163	$ 5,712	$ 2,938
Short-Term Investments	26,067	93,239	79,031	210,316	10,528	419,181	375,339
Total Cash and Short-Term Investments	26,278	95,547	79,430	212,947	10,691	424,893	378,277
Receivables							
Contributions	3,793	36,852	11,293	47,972	2,393	102,303	108,073
Investment Income	1,499	8,401	5,553	17,608	698	33,759	37,523
Total Receivables	5,292	45,253	16,846	65,580	3,091	136,062	145,596
Investments, at fair value							
Corporate and Government Bonds	156,139	862,989	578,076	1,846,615	76,709	3,520,528	3,639,387
Equity Contracts	12	62	42	132	3	251	50
Interest Rate Contracts	1,395	7,563	5,021	15,935	682	30,596	29,477
Foreign Exchange Contracts	593	3,212	2,132	6,768	290	12,995	62,184
Swaps	184	996	661	2,099	90	4,030	1,552
Options	44	238	158	501	22	963	873
Corporate Stocks	297,104	1,615,528	1,055,658	3,350,598	145,365	6,464,253	6,195,476
Mortgages	16,119	97,139	61,915	189,099	7,668	371,940	272,641
Real Estate	11,081	28,248	33,052	98,537	4,026	174,944	54,047
Total Investments, at fair value	482,671	2,615,975	1,736,715	5,510,284	234,855	10,580,500	10,255,687
Securities Lending Collateral Invested	67,714	258,692	251,414	813,671	34,947	1,426,438	1,288,813
Equipment (net of accumulated depreciation)	111	1,309	197	2,254	25	3,896	3,949
Intangible Assets (net of accumulated amortization)	351	4,163	585	7,027	68	12,194	9,832
Total Assets	582,417	3,020,939	2,085,187	6,611,763	283,677	12,583,983	12,082,154
LIABILITIES							
Accounts Payable	111	1,494	202	2,524	32	4,363	39,284
Securities Lending Collateral Obligations	67,714	258,692	251,414	813,671	34,947	1,426,438	1,288,813
Total Liabilities	67,825	260,186	251,616	816,195	34,979	1,430,801	1,328,097
Total Net Position-Held In Trust For Employee Retirement Benefits	$ 514,592	$ 2,760,753	$ 1,833,571	$ 5,795,568	$ 248,698	$ 11,153,182	$ 10,754,057

The accompanying notes are an integral part of the financial statements.

KENTUCKY RETIREMENT SYSTEMS
COMBINING STATEMENT OF CHANGES IN PLAN NET POSITION-PENSION FUNDS
For The Fiscal Year Ended June 30, 2013 (with Comparative Totals For the Fiscal Year Ended June 30, 2012)
(Dollars in Thousands)

	2013						Restated 2012
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
ADDITIONS							
Members' Contributions	$ 11,467	$ 96,744	$ 42,863	$ 120,777	$ 4,495	$ 276,346	$ 274,094
Employers' Contributions	27,334	280,874	120,140	294,914	18,501	741,763	591,453
Health Insurance Contributions (HB1)	402	3,344	734	4,659	48	9,187	7,275
Total Contributions	39,203	380,962	163,737	420,350	23,044	1,027,296	872,822
INVESTMENT (LOSS) INCOME							
From Investing Activities:							
Net (Depreciation) Appreciation in Fair Value of Investments	40,302	236,845	141,113	452,088	20,293	890,641	(261,180)
Interest/Dividends	12,657	76,966	45,198	144,667	6,511	285,999	270,024
Total Investing Activities (Loss) Income	52,959	313,811	186,311	596,755	26,804	1,176,640	8,844
Investment Expense	1,816	12,325	6,111	19,876	999	41,127	37,730
Net (Loss) Income from Investing Activities	51,143	301,486	180,200	576,879	25,805	1,135,513	(28,886)
From Securities Lending Activities:							
Securities Lending Income	367	1,726	1,055	2,615	159	5,922	327
Securities Lending Expense:							
Security Borrower (Income) Rebates	(25)	(9)	(57)	(124)	(9)	(224)	(261)
Security Lending Agent Fees	38	210	141	457	19	865	229
Net Income from Securities Lending Activities	354	1,525	971	2,282	149	5,281	359
Total Net Investment (Loss) Income	51,497	303,011	181,171	579,161	25,954	1,140,794	(28,527)
Total Additions	90,700	683,973	344,908	999,511	48,998	2,168,090	844,295

The accompanying notes are an integral part of the financial statements.

KENTUCKY RETIREMENT SYSTEMS
COMBINING STATEMENT OF CHANGES IN PLAN NET POSITION-PENSION FUNDS
For The Fiscal Year Ended June 30, 2013 (with Comparative Totals For the Fiscal Year Ended June 30, 2012)
(Dollars in Thousands)
(Continued)

	2013						Restated 2012
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
DEDUCTIONS							
Benefit Payments	48,855	873,906	179,696	553,204	50,559	1,706,220	1,649,179
Refunds	2,762	12,907	3,158	13,306	31	32,164	30,977
Administrative Expenses	733	10,719	1,202	17,743	184	30,581	27,785
Capital Project Expenses							17
Total Deductions	52,350	897,532	184,056	584,253	50,774	1,768,965	1,707,958
Net (Decrease) Increase in Net Position	38,350	(213,559)	160,852	415,258	(1,776)	399,125	(863,663)
Total Net Position-Held In Trust For Employee Retirement Benefits							
Beginning of Year	476,242	2,974,312	1,672,719	5,380,310	250,474	10,754,057	11,617,720
End of Year	$ 514,592	$ 2,760,753	$ 1,833,571	$ 5,795,568	$ 248,698	$ 11,153,182	$ 10,754,057

KENTUCKY RETIREMENT SYSTEMS
COMBINING STATEMENT OF PLAN NET POSITION-INSURANCE FUND
As of June 30, 2013 (with Comparative Totals As Of June 30, 2012)
(Dollars in Thousands)

	2013						2012
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
ASSETS							
Cash and Short-Term Investments							
Cash	$ 84	$ 695	$ 74	$ 516	$ 54	$ 1,423	$ 1,232
Short-Term Investments	14,954	34,002	39,709	68,156	6,515	163,336	185,386
Medicare Drug Deposit	11	20	23	43	5	102	101
Total Cash and Short-Term Investments	15,049	34,717	39,806	68,715	6,574	164,861	186,719
Receivables							
Contributions	2,096	12,555	6,196	16,877	1,271	38,995	61,322
Investment Income	1,071	1,382	2,577	4,684	409	10,123	10,616
Total Receivables	3,167	13,937	8,773	21,561	1,680	49,118	71,938
Investments, at fair value							
Corporate and Government Bonds	128,023	159,403	309,623	557,748	48,310	1,203,107	1,085,491
Equity Contracts	7	10	18	32	2	69	2
Interest Rate Contracts	595	756	1,414	2,570	226	5,561	7,279
Swaps	159	202	378	689	60	1,488	289
Foreign Exchange Contracts	365	464	868	1,579	139	3,415	22,630
Options	30	38	71	129	11	279	145
Corporate Stocks	208,979	268,256	491,215	897,454	79,459	1,945,363	1,658,212
Mortgages	11,068	14,003	26,376	47,826	4,215	103,488	75,347
Real Estate	5,638	7,741	13,324	24,439	2,161	53,303	8,101
Total Investments, at fair value	354,864	450,873	843,287	1,532,466	134,583	3,316,073	2,857,496
Security Lending Collateral Invested	54,464	62,666	134,020	240,037	19,921	511,108	199,218
Total Assets	427,544	562,193	1,025,886	1,862,779	162,758	4,041,160	3,315,371
LIABILITIES							
Accounts Payable							
Securities Lending Collateral Obligations	197	3,487	546	3,782	146	8,158	26,840
Total Liabilities	54,464	62,666	134,020	240,037	19,921	511,108	199,218
	54,661	66,153	134,566	243,819	20,067	519,266	226,058
Total Net Position-Held In Trust For Other Post Employment Benefits	$ 372,883	$ 496,040	$ 891,320	$ 1,618,960	$ 142,691	$ 3,521,894	$ 3,089,313

The accompanying notes are an integral part of the financial statements.

KENTUCKY RETIREMENT SYSTEMS
COMBINING STATEMENT OF CHANGES IN PLAN NET POSITION-INSURANCE FUND
For The Fiscal Year Ended June 30, 2013 (with Comparative Totals For the Fiscal Year Ended June 30, 2012)
(Dollars in Thousands)

	2013						2012
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
ADDITIONS							
Employers' Contributions	$ 25,144	$ 162,191	$ 84,962	$ 158,212	$ 16,829	$ 447,338	$ 436,137
Employer Group Waiver Plan	243	4,846	562	5,360	178	11,189	17,800
Premiums Received from Retirees	357	11,154	300	14,512	23	26,346	28,403
Retired Reemployed Healthcare (HB1)	538	3,140	357	1,781		5,816	6,349
Total Contributions	26,282	181,331	86,181	179,865	17,030	490,689	488,689
INVESTMENT (LOSS) INCOME							
From Investing Activities:							
Net (Depreciation) Appreciation in Fair Value of Investments	24,273	30,061	59,305	109,582	9,642	232,863	(118,701)
Interest/Dividends	9,406	11,734	22,496	41,307	3,702	88,645	71,241
Total Investing Activities (Loss) Income	33,679	41,795	81,801	150,889	13,344	321,508	(47,460)
Investment Expense	1,018	1,571	2,306	4,280	424	9,599	8,029
Net (Loss) Income from Investing Activities	32,661	40,224	79,495	146,609	12,920	311,909	(55,489)
From Securities Lending Activities:							
Securities Lending Income	260	471	471	723	83	2,008	84
Securities Lending Expense:							
Security Borrower (Income) Rebates	4	(2)	8	6	(1)	15	(153)
Security Lending Agent Fees	30	36	73	132	11	282	68
Net Income from Securities Lending Activities	226	437	390	585	73	1,711	169
Total Net Investment (Loss) Income	32,887	40,661	79,885	147,194	12,993	313,620	(55,320)
Total Additions	59,169	221,992	166,066	327,059	30,023	804,309	433,369

The accompanying notes are an integral part of the financial statements.

KENTUCKY RETIREMENT SYSTEMS
COMBINING STATEMENT OF CHANGES IN PLAN NET POSITION-INSURANCE FUND
For The Fiscal Year Ended June 30, 2013 (with Comparative Totals For the Fiscal Year Ended June 30, 2012)
(Dollars in Thousands)
(Continued)

	2013						2012
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
DEDUCTIONS							
Healthcare Premiums Subsidies	14,793	109,932	55,842	91,272	11,279	283,118	248,278
Administrative Fees	179	4,285	679	4,431	184	9,758	11,972
Self Funding Insurance Costs	2,044	30,225	4,099	41,217	1,267	78,852	132,144
Total Deductions	17,016	144,442	60,620	136,920	12,730	371,728	392,394
Net Increase in Net Position	42,153	77,550	105,446	190,139	17,293	432,581	40,975
Total Net Position-Held In Trust For Other Post Employment Benefits							
Beginning of Year	330,730	418,490	785,874	1,428,821	125,398	3,089,313	3,048,338
End of Year	$ 372,883	$ 496,040	$ 891,320	$ 1,618,960	$ 142,691	$ 3,521,894	$ 3,089,313

The accompanying notes are an integral part of the financial statements.

NOTES TO FINANCIAL STATEMENTS

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies of the Kentucky Retirement Systems (KRS) is presented to assist in understanding KRS' financial statements. The financial statements and notes are representations of KRS' management, which is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

Organization

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.

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.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Estimates

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

Equipment

Equipment is valued at historical cost and depreciation is computed utilizing the straight-line method over the estimated useful lives of the assets ranging from three to ten years. 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 2013 and 2012 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 2013 and 2012 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.

Investment Income

Due to the timing of receiving partnership financial information, the fair values of the investments in certain limited partnerships have been estimated using the net asset value of the ownership interest in partners' capital as of March 31 of each fiscal year. KRS management will monitor differences in the fair values of these investments between March 31 and June 30, of each fiscal year, and will disclose any and all material differences.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Payment of Benefits

Benefits are recorded when paid.

Expense Allocation

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

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 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 became effective for the fiscal year beginning July 1, 2013. KRS is currently reviewing the Statement's requirements.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (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:

KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	2013			2012		
Number of Members	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
Retirees and Beneficiaries Receiving Benefits	37,240	2,312	39,552	36,508	2,180	38,688
Inactive Vested Memberships	40,375	2,882	43,257	39,445	2,490	41,935
Active Plan Members	40,710	4,057	44,767	42,210	3,540	45,750
Total	118,325	9,251	127,576	118,163	8,210	126,373
Number of Participating Employers	348			385		

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

COUNTY EMPLOYEES RETIREMENT SYSTEM

	2013			2012		
Number of Members	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
Retirees and Beneficiaries						
Receiving Benefits	44,164	5,840	50,004	42,068	5,513	47,581
Inactive Vested Memberships	67,013	1,956	68,969	63,564	1,643	65,207
Active Plan Members	82,631	9,069	91,700	85,779	6,906	92,685
Total	193,808	16,865	210,673	191,411	14,062	205,473
Number of Participating Employers	1,126			1,129		

STATE POLICE RETIREMENT SYSTEM

	2013	2012
Number of Members	Hazardous Position Employees	Hazardous Position Employees
Retirees and Beneficiaries		
Receiving Benefits	1,240	1,203
Inactive Vested Memberships	236	224
Active Plan Members	901	904
Total	2,377	2,331
Number of Participating Employers	1	1

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(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, 2013 and 2012:

	2013					2012				
	Single	Couple/ Family	Parent	Medicare Without Prescription	Medicare With Prescription	Single	Couple/ Family	Parent	Medicare Without Prescription	Medicare With Prescription
KERS Non-Hazardous	9,364	1,276	618	1,474	16,834	9,764	1,917	734	1,721	15,015
KERS Hazardous	625	451	106	60	985	645	517	93	67	751
CERS Non-Hazardous	7,652	857	340	2,707	18,824	7,972	1,317	383	3,119	16,355
CERS Hazardous	1,425	2,155	400	79	2,324	1,385	2,237	310	73	1,853
SPRS	283	421	76	20	682	291	444	62	15	581
Totals	19,349	5,160	1,540	4,340	39,649	20,057	6,432	1,582	4,995	34,555

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 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 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 12 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, 2013, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2013 and 2012, 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

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

through the biennial budget. For the fiscal years ended June 30, 2013 and 2012, participating employers contributed 23.61% and 19.82%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2013 and 2012, were 44.55% and 40.71%, 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.

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 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 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 12 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, 2013, the COLA was not granted.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

Contributions - For the fiscal years ended June 30, 2013 and 2012, 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, 2013 and 2012, participating employers contributed 29.79% and 28.98%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2013 and 2012, were 35.89% and 33.84%, 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.

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.

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

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 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 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 12 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, 2013, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2013 and 2012, 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, 2013 and 2012, participating employers contributed 19.55% and 18.96%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2013 and 2012, were 19.55% and 18.96%, 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.

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

Hazardous Employees Pension Plan

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in hazardous duty positions of each participating county, city and school board, and any additional eligible local agencies electing to participate in CERS. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Prior to July 1, 2009, cost-of-living adjustments (COLA) were provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 5% in any plan year. Effective July 1, 2009, and on July 1 of each year thereafter, the COLA is limited to 1.5% provided the recipient has been receiving a benefit for at least 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 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 12 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, 2013, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2013 and 2012, 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, 2013 and 2012, participating employers contributed 37.6% and 35.76%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2013 and 2012, were 37.6% and 35.76%, 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).

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

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.

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 12 months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than 12 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 12 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, 2013, the COLA was not granted.

Contributions - For the fiscal years ended June 30, 2013 and 2012, 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, 2013 and 2012, the Commonwealth contributed 63.67% and 52.13%, respectively, of each employee's creditable compensation. The actuarially determined rates set by the Board for the fiscal years ended June 30, 2013 and 2012 were 103.41% and 94.63%, respectively, of each employee's creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

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 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, 2013, insurance premiums withheld from benefit payments for members of the systems were $27,574,678 and $1,209,245 for KERS non-hazardous and hazardous, respectively; $27,804,392 and $2,068,890 for CERS non-hazardous and hazardous, respectively; and, $238,774 for SPRS. For fiscal year 2012, insurance premiums withheld from benefit payments for members of KERS were $29,136,828 and $1,235,155 for KERS non-hazardous and KERS hazardous, respectively; $27,541,099 and $1,982,303 for CERS non-hazardous and CERS hazardous, respectively; and, $246,384 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, 2013, the Fund had 100,708 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:

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

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

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 $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 $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 $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.

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 20 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 Wausau 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.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE B - PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION (CONTINUED)

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 became effective January 1, 2013.

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 at June 30:

KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	2013	2012
Cash	$ 2,519,457	$ 1,340,506
Short-Term Investments	119,306,174	120,094,230
Securities Lending Collateral Invested	326,406,362	764,877,463
	$ 448,231,993	$ 886,312,199

COUNTY EMPLOYEES RETIREMENT SYSTEM

	2013	2012
Cash	$ 3,030,064	$ 1,352,380
Short-Term Investments	289,346,687	243,678,862
Securities Lending Collateral Invested	1,065,084,771	505,826,461
	$1,357,461,522	$750,857,703

STATE POLICE RETIREMENT SYSTEM

	2013	2012
Cash	$ 162,872	$ 245,955
Short-Term Investments	10,528,027	11,565,956
Securities Lending Collateral Invested	34,947,388	18,109,078
	$ 45,638,287	$ 29,920,989

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

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

KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND

	2013	2012
Cash	$ 1,422,780	$ 1,230,685
Short-Term Investments	163,336,293	185,385,495
Medicare Drug Deposit	100,001	100,691
Securities Lending Collateral Invested	511,107,721	199,217,159
	$ 675,966,795	$ 385,934,030

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 Exchange Traded Funds' (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

NOTE D - INVESTMENTS (CONTINUED)

purpose of creating a diversified portfolio of alternative investments. The Board may invest in real estate or alternative investments including, but not limited to and without limitation, venture capital, private equity, private placements, real assets and absolute return investments which the Investment Committee believes has excellent potential to generate income and which may have a higher degree of risk.

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

Publicly traded investment grade corporate bonds, variable rate demand notes, government and agency bonds, mortgages, municipal bonds, and collective Short Term Investment Fund's (STIF), 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 FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

As of June 30, 2013, KRS has the following derivative instruments outstanding:

Item	Type	Objective	Cost	Notional Cost	Market Value	Terms	Notional Market Value
Pension:							
Assets							
A	Equity Contracts	Substitute for common stock	$644,329	$0	$253,980	Various	$0
B	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	0	0	5,671,744	Various	0
C	Interest Rate Contracts/ Swaps	Hedge against the risk that interest rates will move in an adverse direction	11,277,287	0	12,909,640	Various	0
D	Swaps	Hedge against sudden or dramatic shifts in interest rates	494,460	0	1,249,208	Various	0
Liabilities							
E	Interest Rate Contracts/ Swaps	Hedge against the risk that interest rates will move in an adverse direction	11,364,674	0	17,685,865	Various	0
F	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	0	0	7,323,378	Various	0
G	Swaps	Hedge against sudden or dramatic shifts in interest rates	3,854,687	0	2,781,142	Various	0
H	Options	Hedge against the holding of an asset	552,357	0	963,493	Various	0

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

Item	Type	Objective	Cost	Notional Cost	Market Value	Terms	Notional Market Value
Insurance:							
Assets							
I	Equity Contracts	Substitute for common stock	$63,771	$0	$69,368	Various	$0
J	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	0	0	1,231,522	Various	0
K	Interest Rate Contracts/ Swaps	Hedge against the risk that interest rates will move in an adverse direction	1,323,467	0	2,244,024	Various	0
L	Swaps	Hedge against sudden or dramatic shifts in interest rates	230,412	0	457,509	Various	0
Liabilities							
M	Interest Rate Contracts/ Swaps	Hedge against the risk that interest rates will move in an adverse direction	1,543,967	0	3,316,619	Various	0
N	Foreign Exchange Contracts	Hedge against the decrease of non US dollar currencies	0	0	2,184,902	Various	0
O	Swaps	Hedge against sudden or dramatic shifts in interest rates	1,041,230	0	1,030,306	Various	0
P	Options	Hedge against the holding of an asset	160,853	0	279,432	Various	0

NOTE D - INVESTMENTS (CONTINUED)

All of the above derivative instruments have various effective dates and maturity dates.

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

Investments in derivative securities which are subject to large or unanticipated changes in duration or cash flows, such as interest only, principal only, inverse floater, or structured note securities are permitted only to the extent authorized in 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 I are substitutes for common stock with an investment that is recorded at fair value.

Derivative instruments B, F, J and N 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 Combining Statement of Plan Net Position for both Pension and Insurance Funds.

Risks:

Basis Risk: Derivative instruments A and I 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, F, J, and N 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, G, H, K, L, M, O, and P expose KRS to interest rate risk in that changes in interest rates will adversely affect the fair values of KRS' financial instruments.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

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 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.

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, 2013 and 2012, deposits for KRS pension funds were $9,333,855 and $30,925,504, respectively. None of these balances were exposed to custodial credit risk as they were either insured or collateralized at required levels.

As of June 30, 2013 and 2012, deposits for KRS insurance fund were $1,430,267 and $3,130,778, 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, 2013 and 2012, 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.

	2013	2012
Pension Funds		
Foreign Currency	$7,380,209	$4,509,853
Insurance Fund		
Foreign Currency	2,352,683	1,736,160

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(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, 2013 and 2012:

	2013	2012
Pension Funds		
US Gov't & Agency Fixed Income Securities	$ 1,582,604,644	$ 1,789,467,703
US Corporate Fixed Income Securities	1,297,990,113	1,222,776,472
Municipal Debt Securities	70,363,221	79,109,093
Short-Term Investments	425,404,014	375,339,048
Equity Securities	4,764,035,886	4,504,816,279
Private Equity Limited Partnerships	1,705,481,097	1,797,263,220
Real Estate	174,943,810	54,047,344
Other*	978,860,163	808,209,209
	$ 10,999,682,948	$10,631,028,368

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

*As of June 30, 2013 and 2012, this balance consists of:

	2013	2012
Cash Collateral – US Dollars	$ 13,401,306	$ 21,644,777
Sukuk***	263,923	495,200
Derivative Offsets:		
Equity Futures	(1,739,458)	(12,467,000)
Hedge Fund	988,790,368	817,486,374
Liabilities:		
Obligation to Return Cash Collateral - US Dollars	(21,855,976)	(18,950,142)
	$ 978,860,163	$ 808,209,209

*** 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.

	2013	2012
Insurance Fund		
US Gov't & Agency Fixed Income Securities	$ 555,483,396	$ 596,153,822
US Corporate Fixed Income Securities	407,385,223	322,100,002
Municipal Debt Securities	14,780,723	15,609,402
Short-Term Investments	164,183,759	185,486,186
Equity Securities	1,605,002,880	1,368,123,183
Private Equity Limited Partnerships	343,283,318	323,438,095
Real Estate	53,302,498	8,100,453
Other**	336,086,682	223,968,702
	$ 3,479,508,479	$ 3,042,979,845

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

**As of June 30, 2013 and 2012, this balance consists of:

	2013	2012
Cash Collateral – US Dollars	$ 2,569,213	$ 5,119,746
Derivative Offsets:		
Equity Futures	25,664,188	(3,005,800)
Hedge Fund	312,234,300	226,403,187
Liabilities:		
Swaps - US Dollars		(2,858,431)
Obligation to Return Cash Collateral - US Dollars	(4,381,019)	(1,690,000)
	$ 336,086,682	$ 223,968,702

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.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

- The duration of the total fixed income portfolio shall not deviate from the KRS Fixed Income by more than 25%.
- The duration of the Treasury Inflation Protected Securities (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.

The following table presents the KRS pension funds debt ratings as of June 30, 2013 and 2012:

Pension Funds
Debt Securities Investments at Fair Value
As of June 30,

Quality Rating	2013	2012
AAA	$ 56,665,771	$ 176,752,688
AA+	68,857,699	51,817,259
AA	19,419,263	19,865,864
AA-	30,605,331	40,184,012
A+	32,370,283	31,408,066
A	71,719,597	80,076,147
A-	109,560,109	108,297,775
BBB+	36,533,579	57,879,171
BBB	109,743,197	103,233,884
BBB-	81,558,127	81,350,025
BB+	62,890,911	56,241,281
BB	66,451,521	63,795,374
BB-	60,743,226	74,378,918
B+	82,924,826	69,386,148
B	77,704,921	70,846,202
B-	50,252,951	57,149,848

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

Pension Funds
Debt Securities Investments at Fair Value
As of June 30,
(Continued)

Quality Rating	2013	2012
CCC+	41,097,638	27,020,113
CCC	17,224,076	20,493,357
CCC-	13,687,724	5,572,497
CC	4,457,848	720,167
D	3,937,401	6,361,973
NR	99,198,973	99,054,796
Total Credit Risk Debt Securities	1,197,604,972	1,301,885,565
Government Bonds	474,844,831	607,041,559
Government Mortgage-Backed Securities (GNMA)	338,663,465	248,950,785
Gov't Issued Commercial Mortgage Backed	9,811,110	10,311,861
Government Agencies	34,674,668	32,423,616
Indexed Linked Bonds	708,142,577	890,739,882
Total Debt Securities	$2,763,741,623	$3,091,353,268

At both June 30, 2013 and 2012, the weighted average quality rating of the pension fund debt securities portfolio was AA+. As of June 30, 2013 and 2012, the KRS pension portfolio had $580,572,016 and $451,965,878, respectively, in debt securities rated below BBB-.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

The following table presents the KRS insurance fund debt ratings as of June 30, 2013 and 2012:

Insurance Fund
Debt Securities Investments at Fair Value
As of June 30

Quality Rating	2013	2012
AAA	$ 17,298,219	$ 99,272,032
AA+	19,036,700	8,741,517
AA	7,906,648	6,899,008
AA-	4,369,454	7,739,207
A+	11,034,344	11,301,734
A	18,123,716	20,358,203
A-	29,449,395	24,992,822
BBB+	8,243,645	11,979,181
BBB	24,640,602	22,934,068
BBB-	25,801,896	15,084,027
BB+	22,285,959	11,563,376
BB	23,613,368	15,166,400
BB-	20,795,416	17,353,229
B+	25,323,893	14,268,206
B	19,984,139	16,588,386
B-	16,449,995	14,831,663
CC	816,507	961,988
CCC	5,087,979	5,522,254
CCC+	10,899,205	5,323,130
CCC-	3,039,033	1,086,041
D	1,088,434	2,118,411
NR	55,438,787	3,624,521
Total Credit Risk Debt Securities	370,727,334	337,709,404
Government Bonds	152,008,017	164,367,747
Government Mortgage-Backed Securities (GNMA)	97,015,116	70,007,438
Gov't Issued Commercial Mortgage Backed	3,007,215	3,156,940
Government Agencies	9,505,690	7,506,492
Indexed Linked Bonds	292,931,190	351,115,205
Total Debt Securities	$ 925,194,562	$ 933,863,226

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(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, 2013, the Pension Funds held $1,604,688, or .02%, and the Insurance Fund held $517,120, or .02%, 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 or other securities 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, 2013, the Pension Funds held $235,623,204, or 2.2%, 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.

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.

NOTE D - INVESTMENTS (CONTINUED)

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, 2013 and 2012, the modified duration of the KRS pension fund fixed income benchmark was 5.38 and 5.02, respectively. At the same points in time, the modified duration of the KRS pension fund fixed income securities portfolio was 5.73 and 5.61, 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, 2013 and 2012, the modified duration of the KRS insurance fund fixed income benchmark was 5.38 and 5.02, respectively. At the same points in time, the modified duration of the KRS insurance fund fixed income securities portfolio was 5.91 and 5.66, respectively.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

KRS Pension Funds Interest Rate Risk
As of June 30,

	2013	Weighted Average Modified Duration	2012	Weighted Average Modified Duration
Asset Backed Securities	$ 44,213,100	2.71	$ 69,305,698	1.28
Bank Loans	105,603,296	4.72	91,076,272	0.14
Collateralized Bonds	14,222,649	0.72	14,259,490	0.07
Commercial Mortgage Backed Securities	66,526,681	3.10	59,670,935	2.90
Commercial Paper	74,997,823	0.02		
Corporate Bonds	674,221,512	5.36	333,162,366	4.70
Corporate Convertible Bonds	19,949,113	8.58	16,819,919	4.10
Government Agencies	34,674,668	5.12	32,423,616	5.20
Government Bonds	474,844,831	5.66	607,041,559	5.70
Government Mortgage Backed Securities	338,663,465	4.20	248,950,785	1.40
Government Issued Commercial Mortgage Backed Securities	9,811,110	2.66	10,311,861	3.30
Hedge Funds	-		335,635,038	
Hedge Multi Strategy	-		3,738,246	
Indexed Linked Government Bonds	708,142,577	8.18	890,739,882	8.30
Municipal Bonds	70,363,221	10.29	79,109,093	10.70
Non-Government Backed Collateralized Mortgage Obligations	10,612,072	2.04	23,690,395	0.93
Other Fixed Income	-		227,154,341	
Short Term Investments	-		39,719,110	
Short Term Bills/Notes	116,631,583	0.17	8,049,462	0.34
Sukuk*	263,923	6.55	495,200	4.20
Total	$2,763,741,624	5.67	$3,091,353,268	5.85

* 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 FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

KRS Insurance Fund Interest Rate Risk
As of June 30,

	2013	Weighted Average Modified Duration	2012	Weighted Average Modified Duration
Asset Backed Securities	$ 14,649,066	3.18	$ 20,616,445	2.40
Bank Loans	28,930,449	4.72	19,461,761	3.90
Collateralized Bonds	4,841,918	1.13	5,256,039	0.80
Commercial Mortgage Backed Securities	17,161,225	3.67	12,783,807	3.30
Commercial Paper	24,998,658	0.04		
Corporate Bonds	216,295,976	5.34	71,656,715	5.80
Corporate Convertible Bonds	4,909,873	8.44	3,788,169	7.90
Fixed Income			83,061,859	
Government Agencies	9,505,690	5.46	7,506,492	6.40
Government Bonds	152,008,017	5.83	164,367,747	5.80
Government Mortgage Backed Securities	97,015,116	4.79	70,007,438	3.10
Government Issued Commercial Mortgage Backed Securities	3,007,215	2.72	3,156,940	3.60
Hedge Fund			85,762,072	
Hedge Multi Strategy			1,584,968	
Indexed Linked Government Bonds	292,931,190	8.25	351,115,205	8.30
Municipal/Provincial Bonds	14,780,723	9.60	15,609,402	10.00
Non-Government Backed Collateralized Mortgage Obligations	2,572,249	1.77	5,339,625	1.10
Short Term Investments			11,619,360	
Short Term Bills/Notes	41,587,197	0.15	1,169,182	0.50
Total	$ 925,194,562	5.92	$ 933,863,226	6.60

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 within 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, some individual managers are given the latitude to hedge some currency exposures.

NOTE D - INVESTMENTS (CONTINUED)

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.

The dynamic currency hedging program previously run by Record Currency Management was terminated on November 3, 2011, and was completely unwound by October 2012.

The following tables present KRS' exposure to foreign currency risk as of June 30, 2013 and 2012:

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

Pension Funds-Investments at Fair Value
June 30,

	2013	2012
Foreign Equities		
Argentine Peso	$ -	$ 592,995
Australian Dollar	59,808,966	58,388,163
Brazilian Real	40,565,297	23,932,101
British Pound Sterling	191,809,147	196,765,497
Canadian Dollar	79,160,793	103,163,185
Chilean Peso	8,572,207	2,675,122
Chinese Yuan	3,921,175	5,183,187
Columbian Peso	4,030,792	3,148,357
Czech Koruna	3,152,676	3,158,280
Danish Krone	12,793,980	8,606,995
Euro	329,323,153	312,248,180
Hong Kong Dollar	96,949,251	90,614,411
Hungarian Forint	4,448,425	1,251,857
Indian Rupee	3,759,830	3,536,235
Indonesian Rupiah	7,187,236	14,715,167
Israeli Shekel	2,069,010	1,703,453
Japanese Yen	263,796,152	232,665,797
Malaysian Ringgit	5,704,224	3,068,235
Mexican Peso	22,181,651	18,202,265
New Taiwan Dollar	-	25,479,684
New Zealand Dollar	7,500,911	1,013,380
Norwegian Krone	9,727,168	4,046,964
Peruvian Nuevo Sol	471,934	1,216,727
Philippine Peso	3,021,216	6,438,447
Polish Zloty	5,945,095	4,802,910
Russian Ruble	7,159,994	7,570,244
Singapore Dollar	19,834,359	22,349,886
South African Rand	23,424,203	23,545,955
South Korean Won	50,679,693	70,999,258
Swedish Krona	28,143,780	27,191,886
Swiss Franc	96,580,108	81,004,268
Taiwan Dollar	35,426,792	-
Thai Bhat	5,867,698	9,159,880
Turkish Lira	4,549,826	6,233,784
Total Securities subject to Foreign Currency Risk	1,437,566,742	1,374,672,755
USD (securities held by International Investment Managers)	9,562,116,206	9,256,355,650
Total International Investment Securities	$ 10,999,682,948	$ 10,631,028,405

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE D - INVESTMENTS (CONTINUED)

Insurance FunD - INVESTMENTS at Fair Value
June 30,

	2013	2012
Foreign Equities		
Australian Dollar	$ 17,372,842	$ 20,374,499
Brazilian Real	11,659,097	6,775,870
British Pound Sterling	61,860,945	69,217,342
Canadian Dollar	25,663,239	35,948,462
Chilean Peso	2,724,948	786,711
Chinese Yuan	1,214,863	1,298,990
Columbian Peso	1,036,746	796,126
Czech Koruna	1,072,552	990,353
Danish Krone	4,233,231	2,959,795
Euro	105,942,398	105,768,977
Hong Kong Dollar	30,780,462	31,672,609
Hungarian Forint	1,415,885	315,114
Indian Rupee	1,149,108	882,340
Indonesian Rupiah	2,005,381	4,828,536
Israeli Shekel	639,441	429,103
Japanese Yen	84,659,071	79,821,116
Malaysian Ringgit	1,618,726	740,285
Mexican Peso	6,607,537	4,224,645
New Taiwan Dollar	-	8,671,587
New Zealand Dollar	2,131,571	296,011
Norwegian Krone	3,039,601	1,355,472
Peruvian Nuevo Sol	108,768	304,965
Philippine Peso	633,481	1,699,557
Polish Zloty	1,829,456	1,263,786
Russian Ruble	2,274,414	1,762,447
Singapore Dollar	6,063,920	7,014,550
South African Rand	7,537,217	7,916,313
South Korean Won	15,998,698	23,790,001
Swedish Krona	9,106,266	9,210,394
Swiss Franc	30,623,672	28,469,252
Taiwan Dollar	11,121,400	-
Thai Bhat	1,627,962	3,108,109
Turkish Lira	1,456,908	2,072,912
Total Securities subject to Foreign Currency Risk	455,209,806	464,766,229
USD (securities held by International Investment Managers)	3,024,298,673	2,578,213,716
Total International Investment Securities	$ 3,479,508,479	$ 3,042,979,945

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% 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, 2013, 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 - RISK 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 self-insured retention of $250,000 for each claim. 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.

NOTE F - RISK 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 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 exposed to risks of loss from various legal proceedings, some of which could have a material impact if the decisions are adverse. However, as of the date of this report, the likelihood of incurring such a loss cannot be determined and a dollar amount cannot be reasonably estimated.

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 year 2013.

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, 2013, 2012, and 2011. Plan members who began participating on, or after, September 1, 2008, contributed 6% of creditable compensation for the periods ended June 30, 2013, 2012, and 2011. KRS contributed 23.61%, 19.82%, and 16.98%, of covered payroll for the periods ended June 30, 2013, 2012, and 2011, respectively.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE I - DEFINED BENEFIT PENSION PLAN (CONTINUED)

The chart below includes the covered payroll and contribution amounts for KRS for the three periods ended June 30 included in this discussion.

	June 30, 2013	June 30, 2012	June 30, 2011
Covered Payroll	$ 13,925,712	$ 13,784,847	$ 13,444,315
Required Employer Contributions	3,271,165	2,726,780	2,282,864
Employer Percentage Contributed	100%	100%	100%

NOTE J - EQUIPMENT

Equipment consists of the following:

	June 30, 2013	June 30, 2012
Equipment, at cost	$ 6,752,838	$ 6,753,648
Less Accumulated Depreciation	(2,856,799)	(2,805,034)
Equipment (Net of Accumulated Depreciation)	$ 3,896,039	$ 3,948,614

Depreciation expense for the fiscal years ended June 30, 2013 and 2012 amounted to $52,575 and $68,471, respectively. The decrease in equipment at cost is due to some assets being fully depreciated as of June 30, 2013.

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 Position 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, 2013	June 30, 2012
Software, at cost	$16,254,290	$12,724,117
Less Accumulated Amortization	(4,059,389)	(2,893,011)
Intangible Assets (Net of Accumulated Amortization)	$12,194,901	$ 9,831,106

Amortization expense for the fiscal years ended June 30, 2013 and 2012 amounted to $1,166,377 and $1,210,750, respectively. The increase in software at cost is due to the capitalization of the final costs associated with the START project.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(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 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 Financial Statements:

PENSION FUNDS

	Non-Hazardous	Hazardous
Valuation Date	June 30, 2013	June 30, 2013
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	30 Years	30 Years
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market
Actuarial Assumptions:		
Investment Return*	7.75%	7.75%
**Includes Price Inflation at*	3.5%	3.5%
Projected Salary Increases**	4.75%-17.0%	4.5%-21.0%
Cost of Living Adjustment	None	None
***Includes Wage Inflation at*	4.5%	4.5%

INSURANCE FUND***

	Non-Hazardous	Hazardous
Valuation Date	June 30, 2013	June 30, 2013
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	30 Years	30 Years
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market
Medical Trend Assumption:		
Pre-Medicare	8.5%-5.0%	8.5%-5.0%
Post-Medicare	7.0%-5.0%	7.0%-5.0%
Year of Ultimate Trend	2019	2019
Actuarial Assumptions:		
Investment Rate of Return*	7.75%**	7.75%
**Includes Price Inflation at*	3.5%	3.5%

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE L - ACTUARIAL VALUATION (CONTINUED)

**The actuarial investment rate of return for developing insurance liabilities and contribution rates is 7.75% 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 investment rate of return for developing insurance liabilities and contribution rates assumption was changed for FY12 from 4.5% to 7.5% in FY13. The change impacted the Schedule of Funding Progress-Insurance actuarial accrued liability for KERS Nonhazardous and SPRS. The FY12 information in the Schedule of Funding Progress was not restated from FY12. However, the revised assumption rate of 7.5% was used in calculating the FY13 actuarial accrued liability.

***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:

	2013	2012
Pension Funds:		
Kentucky Employees Retirement System (Non-Hazardous)	$ 8,750,479,307	$ 8,259,731,398
Kentucky Employees Retirement System (Hazardous)	278,323,786	255,473,161
County Employees Retirement System (Non-Hazardous)	3,741,781,631	3,592,332,096
County Employees Retirement System (Hazardous)	1,322,514,183	1,262,612,750
State Police Retirement System	409,780,326	387,897,090
Total Pension Funds	14,502,879,233	13,758,046,495
Insurance Fund:		
Kentucky Employees Retirement System (Non-Hazardous)	1,631,169,807	2,679,249,646
Kentucky Employees Retirement System (Hazardous)	14,743,272	39,018,458
County Employees Retirement System (Non-Hazardous)	815,649,903	857,917,437
County Employees Retirement System (Hazardous)	544,558,426	535,802,215
State Police Retirement System	86,005,683	209,531,710
Total Insurance Fund	3,092,127,091	4,321,519,466
Total Unfunded Actuarial Accrued Liability	$17,595,006,324	$18,079,565,961

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE L - ACTUARIAL VALUATION (CONTINUED)

The following is the Schedule of Funding Progress for the fiscal year ended June 30, 2013:

	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age Normal	Percent Funded	Covered Payroll	Unfunded AAL as a % of Covered Payroll
Pension Funds:					
Kentucky Employees Retirement System (Non-Hazardous)	$2,636,122,852	$11,386,602,159	23.2	$1,644,408,698	532.1
Kentucky Employees Retirement System (Hazardous)	505,656,808	783,980,594	64.5	132,015,368	210.8
County Employees Retirement System (Non-Hazardous)	5,637,094,483	9,378,876,114	60.1	2,236,277,489	167.3
County Employees Retirement System (Hazardous)	1,801,691,410	3,124,205,593	57.7	461,672,567	286.5
State Police Retirement System	241,800,328	651,580,654	37.1	45,256,202	905.5
Total Pension Funds	10,822,365,881	25,325,245,114	42.6	4,519,630,324	562.3
Insurance Fund:					
Kentucky Employees Retirement System (Non-Hazardous)	497,584,327	2,128,754,134	23.4	1,644,408,698	99.2
Kentucky Employees Retirement System (Hazardous)	370,774,403	385,517,675	96.2	132,015,368	11.2
County Employees Retirement System (Non-Hazardous)	1,628,244,197	2,443,894,100	66.6	2,236,277,489	36.5
County Employees Retirement System (Hazardous)	892,774,391	1,437,332,817	62.1	461,672,567	118.0
State Police Retirement System	136,321,060	222,326,743	61.3	45,256,202	190.0
Total Insurance Fund	3,525,698,378	6,617,825,469	53.3	4,519,630,324	146.4
Totals	$14,348,064,259	$31,943,070,583	44.8	$9,039,260,648	354.4

The Schedule of Funding Progress for the Pension Funds is on pages 69 through 71. The Schedule of Funding Progress for the Insurance Fund is on pages 72 through 74.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(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 2013 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 year 2013 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, 2012) for fiscal year 2013:

KERS-Non Hazardous	23.61%
KERS-Hazardous	29.79%
CERS-Non Hazardous	19.55%
CERS-Hazardous	37.6%
SPRS	63.67%

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.

NOTE M - HOUSE BILL 1 PENSION REFORM (CONTINUED)

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 year 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, 2013 and 2012, the Insolvency Account amounted to $100,001 and $100,691, respectively.

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, 2013 and 2012, the reimbursement totaled $9,187,367 and $6,349,929, respectively.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

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 year 1986 to fiscal year 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.

In April 2012, KRS received $3,866,429 and in July 2012, KRS received an additional $7,000,000, for interest owed, which by settlement extinguished the liability to KRS.

NOTE R - RECIPROCITY 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.

NOTE S - CUSTODIAL BANK

As a result of a thorough Request for Proposal (RFP) process, and effective July 1, 2013, Bank of New York-Mellon became responsible for providing KRS all required global custodial services. Bank of New York-Mellon took these duties over from Northern Trust, the former custodial bank.

KENTUCKY RETIREMENT SYSTEMS
NOTES TO FINANCIAL STATEMENTS
June 30, 2013
(Continued)

NOTE T - RELATED PARTY

Perimeter Park West, Inc. (PPW) is a legally separate, tax-exempt Kentucky corporation established in 1998 to own the land and buildings on which KRS is located. PPW leases the buildings to KRS (the lease is renewed every five years) and provides maintenance for the buildings and land. PPW is considered a related party to KRS and has its own separate financial audit. The following presents the amounts recorded between KRS and PPW for the fiscal year ended June 30, 2013:

Lease payments to PPW from KRS: $1,131,065

Dividends to KRS from PPW: $ 485,030

NOTE U - SUBSEQUENT EVENTS

Management has evaluated the period from June 30, 2013, to December 5, 2013, (the date the financial statements were available to be issued) for items requiring recognition or disclosure in the financial statements.

NOTE V - RESTATEMENT

The Pension Funds' Net Position as of June 30, 2012, and the decrease in the Pension Funds' Net Position for the fiscal year then ended, have been restated to correct accrued contributions and Health Insurance Contributions at June 30, 2012. See detailed note below.

	As Previously Reported	As Restated
Pension Fund:		
Contributions Receivable	$ 112,722	$ 108,073
Total Net Position	10,758,706	10,754,057
Health Insurance Contributions	11,924	7,275
Net Decrease in Net Position	859,014	863,663

The net effect of this correction was a decrease of $4,647,263 in pension contributions and health insurance contributions for the fiscal year ended June 30, 2012. The restatement resulted from the failure of an adjusting entry to be reflected in the financial statements.

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REQUIRED SUPPLEMENTARY INFORMATION

KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013

Schedules of Funding Progress

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS) - PENSION FUNDS

Non-Hazardous	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	$ 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
June 30, 2013	2,636,122,852	11,386,602,159	8,750,479,307	23.2	1,644,408,698	532.1
Hazardous						
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
June 30, 2013	505,656,808	783,980,594	278,323,786	64.5	132,015,368	210.8
Total						
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
June 30, 2013	3,141,779,660	12,170,582,753	9,028,803,093	25.8	1,776,424,066	508.3

**Actuarially Computed

KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

Schedules of Funding Progress

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS) - PENSION FUNDS

Non-Hazardous	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	$ 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
June 30, 2013	5,637,094,483	9,378,876,114	3,741,781,631	60.1	2,236,277,489	167.3
Hazardous						
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
June 30, 2013	1,801,691,410	3,124,205,593	1,322,514,183	57.7	461,672,567	286.5
Total						
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	12,149,559,742	4,854,944,846	60.0	2,700,775,268	179.8
June 30, 2013	7,438,785,893	12,503,081,707	5,064,295,814	59.5	2,697,950,056	187.7

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KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

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
June 30, 2013	241,800,328	651,580,654	409,780,326	37.1	45,256,202	905.5

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KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

Schedules of Funding Progress

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS) - INSURANCE FUND

Non-Hazardous	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	$ 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
June 30, 2013	497,584,327	2,128,754,134	1,631,169,807	23.4	1,644,408,698	99.2
Hazardous						
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
June 30, 2013	370,774,403	385,517,675	14,743,272	96.2	132,015,368	11.2
Total						
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
June 30, 2013	868,358,730	2,514,271,809	1,645,913,079	34.5	1,776,424,066	92.7

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KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

Schedules of Funding Progress

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS) - INSURANCE FUNDS

Non-Hazardous	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	$ 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
June 30, 2013	1,628,244,197	2,443,894,100	815,649,903	66.6	2,236,277,489	36.5
Hazardous						
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
June 30, 2013	892,774,391	1,437,332,817	544,558,426	62.1	461,672,567	118.0
Total						
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
June 30, 2013	2,521,018,588	3,881,226,917	1,360,208,329	65.0	2,697,950,056	50.4

**Actuarially Computed

KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

Schedules of Funding Progress

STATE POLICE RETIREMENT SYSTEM (SPRS) - INSURANCE 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	$ 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
June 30, 2013	136,321,060	222,326,743	86,005,683	61.3	45,256,202	190.0

**Actuarially Computed

KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

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
June 30, 2013	485,395,934	280,874,152		57.9

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
June 30, 2013	286,143,134	165,330,557		57.8

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
June 30, 2013	771,539,068	446,204,709		57.8

KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

Schedules of Contributions from Employers and Other Contributing Entities

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)
HAZARDOUS EMPLOYEES

Pension

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2004	$ 9,600,978	$ 9,769,580	$	101.8
June 30, 2005	9,449,878	9,758,547		103.3
June 30, 2006	10,787,472	10,803,206		100.1
June 30, 2007	12,219,689	13,237,321		108.3
June 30, 2008	14,147,341	15,257,079		107.8
June 30, 2009	15,708,254	15,843,289		100.9
June 30, 2010	17,814,630	17,658,058		99.1
June 30, 2011	20,605,070	19,140,508		92.9
June 30, 2012	20,264,754	20,808,540		102.7
June 30, 2013	21,501,581	27,333,681		127.1

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2004	$ 14,942,092	$ 14,959,617	$	100.1
June 30, 2005	15,892,977	15,395,977		96.9
June 30, 2006	28,517,563	17,011,745		59.7
June 30, 2007	31,304,778	19,534,819	104,669	62.7
June 30, 2008	51,214,929	21,997,341	73,891	43.1
June 30, 2009	34,670,467	20,807,204	186,081	60.6
June 30, 2010	35,045,278	21,921,535	319,059	63.5
June 30, 2011	29,585,257	19,952,580		67.4
June 30, 2012	28,326,206	24,538,087		86.6
June 30, 2013	26,252,911	25,682,403		97.8

Total

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2004	$ 24,543,070	$ 24,729,197	$	100.8
June 30, 2005	25,342,855	25,154,524		99.3
June 30, 2006	39,305,035	27,814,951		70.8
June 30, 2007	43,524,467	32,772,140	104,669	75.5
June 30, 2008	65,362,270	37,254,420	73,891	57.1
June 30, 2009	50,378,721	36,650,493	186,081	73.1
June 30, 2010	52,859,908	39,579,593	319,059	75.5
June 30, 2011	50,190,327	39,093,088		77.9
June 30, 2012	48,590,960	45,346,627		93.3
June 30, 2013	47,754,492	53,016,084		111.0

KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

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
June 30, 2013	294,914,244	294,914,244		100.0

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	49.7
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
June 30, 2013	195,560,870	159,992,643		81.8

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
June 30, 2013	490,475,114	454,906,887		92.7

KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

Schedules of Contributions from Employers and Other Contributing Entities

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)
HAZARDOUS EMPLOYEES

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
June 30, 2013	120,139,906	120,139,906		100.0

Insurance

Year Ended	Annual Required Contributions	Actual Contributions	Retiree Drug Subsidy Contributions	Percentage Contributed
June 30, 2004	$ 47,018,046	$ 47,036,777	$	100.0
June 30, 2005	54,094,495	54,106,577		100.0
June 30, 2006	98,297,535	64,853,778		66.0
June 30, 2007	115,938,899	70,072,785	656,523	61.0
June 30, 2008	168,723,639	90,113,200	419,774	53.7
June 30, 2009	126,757,348	70,785,241	627,938	56.3
June 30, 2010	129,227,449	83,042,875	1,493,440	65.4
June 30, 2011	109,226,667	98,592,286		90.3
June 30, 2012	110,762,577	92,563,664		83.6
June 30, 2013	102,010,672	85,319,393		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	188,022,269	183,670,467		97.7
June 30, 2012	194,351,535	181,892,881		93.6
June 30, 2013	222,150,578	205,459,299		92.5

KENTUCKY RETIREMENT SYSTEMS
REQUIRED SUPPLEMENTARY INFORMATION
June 30, 2013
(Continued)

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
June 30, 2013	23,117,291	18,501,090		80.0

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
June 30, 2013	27,234,229	16,828,681		61.8

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
June 30, 2013	50,351,520	35,329,771		70.2

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ADDITIONAL SUPPORTING SCHEDULES

KENTUCKY RETIREMENT SYSTEMS
ADDITIONAL SUPPORTING SCHEDULES

Schedule of Administrative Expenses
For the Fiscal Years Ended June 30,
(Dollars in Thousands)

	2013	2012
Personnel		
Salaries and Per Diem	$ 14,987	$ 14,316
Fringe Benefits	6,349	5,561
Tuition Assistance	26	31
Total Personnel	21,362	19,908
Contractual		
Actuarial Services	401	297
Audit Services	169	30
Healthcare	135	
Human Resources	54	40
Legal Counsel	746	806
Medical Review Services	381	229
Miscellaneous	194	1,008
Total Contractual	2,080	2,410
Communication		
Printing	272	299
Telephone	154	132
Postage	507	525
Travel	101	182
Total Communication	1,034	1,138
Internal Audit		
Travel/Conferences	3	1
Dues/Subscriptions	1	2
Miscellaneous		1
Total Internal Audit	4	4
Investments (Pension Fund)		
Travel/Conferences	60	41
Dues/Subscriptions	41	26
Software	180	149
Contractual	1,513	858
Miscellaneous	9	15
Legal	126	265
Total Investments	1,929	1,354

KENTUCKY RETIREMENT SYSTEMS
ADDITIONAL SUPPORTING SCHEDULES

Schedule of Administrative Expenses
For the Fiscal Years Ended June 30,
(Dollars in Thousands)
(Continued)

	2013	2012
Rentals		
Office Space	1,165	1,144
Equipment	54	91
Total Rentals	1,219	1,235
Miscellaneous		
Utilities	206	201
Software	1,168	
Supplies	153	140
Insurance	67	76
Maintenance	15	40
Other	122	
Total Miscellaneous	1,731	457
Depreciation/Amortization	1,219	1,279
Total Pension Fund Administrative Expense	30,578	27,785
Investment Expenses (Insurance Fund)		
Investment Consultant		246
Investment Related Travel		9
Dues & Subscriptions		7
Conferences		3
Miscellaneous		4
Software		43
Legal Counsel		76
Total Investment Expenses (Insurance Fund)		388
Healthcare Fees	9,759	11,584
Total Insurance Fund Administrative Expense	9,759	11,972
Total Administrative Expenses	$ 40,337	$ 39,757

KENTUCKY RETIREMENT SYSTEMS
ADDITIONAL SUPPORTING SCHEDULES

Schedule of Direct Investment Expenses
For the Fiscal Years Ended June 30
(Dollars in Thousands)

	2013	2012
PENSION FUNDS		
Security Lending Fees		
Broker (Income) Rebates	$ (224)	$ (261)
Lending Agent Fees	865	229
Total Security Lending	641	(32)
Contractual Services		
Investment Management	41,128	37,730
Security Custody/Investment Consultant	1,513	858
Investment Related Travel	52	31
Software	180	149
Dues & Subscriptions	41	26
Conferences	8	10
Miscellaneous	9	15
Legal Counsel	126	265
Total Contractual Services	43,057	39,084
INSURANCE FUND		
Security Lending Fees		
Broker (Income) Rebates	15	(153)
Lending Agent Fees	282	68
Total Security Lending	297	(85)
Contractual Services		
Investment Management	9,599	8,029
Security Custody/Investment Consultant		246
Investment Related Travel		9
Dues & Subscriptions		7
Conferences		3
Miscellaneous		4
Software		43
Legal Counsel		76
Total Contractual Services	9,599	8,417
Total Investment Expenses	$ 53,594	$ 47,384

Schedule of Professional Consultant Fees
For the Fiscal Years Ended June 30
(Dollars in Thousands)

	2013	2012
Actuarial Services	$ 401	$ 297
Medical Review Services	381	229
Audit Services	169	30
Legal Counsel	872	806
Compliance		98
Workflow		28
Healthcare	135	699
Banking	9	66
Human Resources	54	40
Miscellaneous	186	117
Total	$ 2,207	$ 2,410

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

Adam H. Edelen
Auditor of Public Accounts

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*

Independent Auditor's Report

Board of Trustees
Kentucky Retirement Systems
Frankfort, Kentucky

We have audited, in accordance with the 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, the financial statements of the Kentucky Retirement Systems (KRS) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the KRS' basic financial statements, and have issued our report thereon dated December 5, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the KRS' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the KRS' internal control. Accordingly, we do not express an opinion on the effectiveness of the KRS' internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain

209 St. Clair Street
Frankfort, KY 40601-1817
Telephone 502.564.5841
Facsimile 502.564.2912
www.auditor.ky.gov

deficiencies in internal control, described in the accompanying schedule of findings and recommendations that we consider to be a significant deficiencies as identified as findings 2013-KRS-01; 2013-KRS-02; 2013-KRS-03; 2013-KRS-04; 2013-KRS-05; 2013-KRS-06; 2013-KRS-07; 2013-KRS-08;. 2013-KRS-09; 2013-KRS-10; 2013-KRS-11; 2013-KRS-12; 2013-KRS-13; 2013-KRS-14; 2013-KRS-15; 2013-KRS-16; 2013-KRS-17; 2013-KRS-18; and 2013-KRS-19.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the KRS' 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*.

KRS' Response to the Findings and Recommendations

KRS' response to the findings identified in our audit is described in the accompanying schedule of findings and recommendations. KRS' response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Additional Management Communication

We noted certain matters that we have reported to management of the KRS' in a separate letter dated December 5, 2013.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully Submitted,

Adam H. Edelen
Auditor of Public Accounts

December 5, 2013

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013

2013-KRS-01: KRS' Accounting System Does Not Have An Adequate Function Allowing For Supervisory Approvals Of Journal Entries

During the FY13 audit of Kentucky Retirement Systems, we noted the Great Plains accounting system (the financial reporting system used by KRS) does not have an adequate function allowing for supervisory approvals of journal entries. The Division of Accounting staff record financial transactions for KRS in Great Plains. There is no computerized method of documenting if a journal entry into Great Plains is accurate and approved. Manual approvals are supposed to occur prior to entry into Great Plains; however, there is no way to verify the information was entered into Great Plains correctly without an electronic approval.

We reviewed supporting documentation for journal entries to determine if a manual review and approval process was in place for transactions prior to entry into Great Plains. We noted the following:

- Out of 50 administrative expenditures tested, seven documents were not initialed as approved by the controller for payment prior to entry into Great Plains. However, in five cases, the Executive Director authorized payment.
- Monthly JVs are prepared to record investment amounts into the appropriate pension plans. A spreadsheet with this information is prepared by Cash Management staff and given to Accounting staff for entry into KRS' financial reporting system (known as Great Plains). Since there is no approval of any journal entries in Great Plains, no one reviews or approves the entry for accuracy and completeness. A data entry error related to interest income could possibly be caught by the Assistant Controller when the monthly financial reconciliation between Great Plains and the custodian bank is performed. However, no documentation of the reconciliation is maintained. Additional reconciliations are performed at year end for investments and investment income.

There is not an adequate function in Great Plains allowing a reviewer to enter approval. According to KRS personnel, the controller initials all administrative expenditure documents prior to approval for payment. Regarding the monthly manual JVs, there is currently no audit trail showing the entries were made in Great Plains and that monthly reconciliations were performed which would catch some errors.

Without a system of approvals in place after the transactions are entered into the financial system, data entry errors and unauthorized entries could occur and remain undetected. Great Plains journal entries are uploaded into eMARS if a payment is to be made. Unauthorized payments or payments for incorrect amounts could be made and a check issued before detection. There are 42 KRS personnel with varying levels of access to Great Plains.

Two administrative expenditures were not approved by appropriate personnel prior to entry into Great Plains.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-01: KRS' Accounting System Does Not Have An Adequate Function Allowing Supervisory Approval Of Journal Entries (Continued)

Regarding the JVs, without documentation of the monthly financial reconciliation we cannot confirm the reconciliation was done nor determine the amount of investment income data entry errors occurring.

Good internal controls dictate accounting transactions should be reviewed and approved after entry into a financial reporting system, such as Great Plains. Since this control is not possible due to the limitations of the Great Plains system, alternative controls should be established and documented.

The *Accounting Division Policy and Procedures Manual* under Payment of Vendor Invoices 1.2 states, "The administrative accountant should verify authorization of payment for the invoice by verifying the initials of the accounting director and the Chief Operations Officer. 1.2.1 If the invoice does not contain the appropriate signatures, the accountant should forward the invoice to the appropriate person for authorization for payment."

Recommendation

We recommend KRS:

- Evaluate the ability to use eMARS, the statewide financial accounting system. KRS uses eMARS to issue all checks and record receipt of funds. Journal entry supporting documentation could be attached to and approvals could be applied to the eMARS document by a KRS supervisor.
- Determine if an approval process in Great Plains is possible and feasible.
- Evaluate and improve the current manual approval process to ensure all journal entries are authorized and accurate.

Management's Response and Corrective Action Plan

KRS agrees with the finding.

Management will evaluate the feasibility of implementing the eMARS System more extensively. However, as stated in 2013-KRS-03, there are circumstances that must be evaluated.

Management will work with the Division of Information Technology to determine if an electronic approval process is available in Great Plains (general ledger system). As part of the manual posting of general ledger entries, management will implement a review and approval process.

Management will update the Accounting Division Policy and Procedures Manual with any changes to include the review and approval processes.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-02: KRS Did Not Adequately Segregate Duties For Certain Accounts Receivable And Reconciliation Processes

During the FY 13 audit of Kentucky Retirement Systems, we noted segregation of duties issues related to accounts receivable and reconciling the Commonwealth's accounting system to KRS' financial reporting system. There is no review or approval process in place for these transactions and reconciliations.

KRS records accounts receivable at the end of each quarter in Great Plains, KRS' financial reporting system. Each quarter the accounts receivable entry is prepared and entered into Great Plains by the Controller without approval or review from other personnel. We reviewed two separate quarters and found the following:

Quarter ended December 31, 2012:

- The allocation percentage per plan for the Securities and Lending Insurance Income accrual was incorrect, resulting in the following:

Securities Lending Accrual-December 2012

Plan	KRS Journal Entry	Auditor Calculation	Difference
KERS	$ 18,404	$ 18,762	$ (358)
CERS	64,150	63,876	274
SPRS	5,612	5,653	(40)
CHAZ	35,412	35,333	79
KHAZ	14,931	14,886	44
	$ 138,509	$ 138,509	$ 0

- The State Police Retirement System (SPRS) member contribution accrual is incorrectly stated. The accrual should be $176,782 but was recorded as $176,827, a difference of $45.

Quarter ended June 30, 2013:

- The KERS Hazardous Health Insurance Contribution accrual should be $36,002, but was recorded as $34,640.
- The KERS Hazardous Member Contributions accrual should be $933,785, but was recorded as $36,002.
- The CERS Hazardous Employer Insurance accrual should be $8,189,936, but was recorded as $21,392,299.

<u>2013-KRS-02:</u> KRS Did Not Adequately Segregate Duties For Certain Accounts Receivable And Reconciliation Processes (Continued)

The June 2013 quarter amounts are reversed and a new journal entry is done using actual July 2013 contributions for year-end financial statement reporting. However, if the Board of Trustees meets in July 2013, they receive the draft financial statements using the June 2013 quarter amounts recorded.

Another segregation of duties issue is that the eMARS (enhanced Management and Administrative Reporting system) and Great Plains reconciliations as well as bank reconciliations are prepared by one of KRS' employees and not reviewed by another member of KRS' Division of Accounting staff.

Third, in April of 2013, KRS implemented a reconciliation process to ensure funds received have been qualified. Qualification is the process of moving funds from the KRS clearing account to the custodial bank. This reconciliation between START and Great Plains is prepared by one employee of KRS and is not being reviewed by another member of KRS' staff.

Lack of the review and approval process can cause material misstatements being reported on the financial statement whether intentional or unintentional. Also, without additional employees responsible for portions of recording the accounts receivable and preparing reconciliations, KRS could have problems in the absence of the responsible employee or makes an error which could have been prevented by segregating duties.

The objective of segregation of duties is to ensure assigned duties are separated so no one employee is in a position both to commit and conceal errors while performing their assigned duties. Adequate segregation of duties reduces the likelihood that errors, either intentional or unintentional, will remain undetected. This is carried out by providing for separate processing by different individuals at various states of a transaction and by independent reviews of the work performed.

<u>Recommendation</u>

We recommend KRS:

- Implement a review and approval process for the recording of accounts receivable to ensure correct calculations.
- Having a person review and approve reconciliations.

<u>Management's Response and Corrective Action Plan</u>

KRS agrees with this finding.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-02: KRS Did Not Adequately Segregate Duties For Certain Accounts Receivable And Reconciliation Processes (Continued)

Management's Response and Corrective Action Plan (Continued)

Although the monetary discrepancies were immaterial based upon prior audit experience, management understands its importance and will ensure that employer/member contribution receivables are reviewed and approved prior to posting. The Accounting Division Policy and Procedures Manual will be updated to include this new procedure.

Auditors' Reply

The APA acknowledges that the discrepancies identified during the audit were immaterial, but would like to clarify for KRS management that the nature of the weakness noted could have permitted material discrepancies to occur without detection. As noted in the finding, a lack of segregation of duties may lead to intentional or unintentional errors, meaning that it increases the risk of waste, fraud, and abuse.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-03: Revenues And Expenditures In EMARS And KRS' Financial Reporting System Are Not Reconciled

During the FY13 audit, we analyzed the revenues and expenditures for the Kentucky Retirement Systems (KRS) by fund, as recorded in eMARS (Enhanced Management and Reporting System). KRS maintains a separate system, known as Great Plains, for financial reporting. However, all KRS revenues are entered into the eMARS system and all expenditures (checks issued by the Kentucky State Treasurer) are from eMARS. The revenue source codes and expenditure object codes are how revenues and expenditures are classified in eMARS.

While conducting the analysis, we learned some of KRS' eMARS accounts were not coded with the correct revenue source code and expenditure object codes. KRS reconciles the cash balances recorded in Great Plains to the cash totals in eMARS; however, the revenues and expenditures between the two systems are not reconciled or reviewed. When receiving funds from the custodian bank, KRS personnel manually update eMARS because the documents do not upload into eMARS. KRS personnel do not have a thorough understanding of the revenue and expenditure codes in eMARS and this has resulted in inconsistent codes being used.

For many KRS accounts, the coding was created at eMARS implementation, many years ago. When subsequent staff created new accounts, the coding was not always evaluated to determine if it was correct due to a lack of adequate understanding of eMARS.

KRS coding in eMARS is not accurate. Errors noted in Great Plains are fixed in Great Plains by JVs, but these JVs are not uploaded to eMARS to correct eMARS.

Good internal controls dictate that staff be knowledgeable about the recording of revenues and expenditures in the system handling the receipt and expenditure of cash.

Recommendation

We recommend KRS:

- Review the codes to ensure they are coded correctly.
- Consider reconciling the revenues and expenditures, at least at the fund level.
- Ensure staff is adequately trained as it relates to eMARS.

Management's Response and Corrective Action Plan

KRS agrees with this finding.

KRS agrees to review the eMARS codes and ensure that staff is adequately trained with regards to eMARS.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-03: Revenues And Expenditures In EMARS And KRS' Financial Reporting System Are Not Reconciled (Continued)

Management's Response and Corrective Action Plan (Continued)

KRS reconciles cash to eMARS; however, the process to reconcile revenue and expense has never been implemented because information at this level is pulled from Great Plains.

KRS will evaluate eMARS capabilities and determine the feasibility. However, in order to reconcile revenue and expenses at the fund level in eMARS, a complete bookkeeping within the eMARS Accounting System would be required. In addition, this would require KRS to maintain two sets of books (i.e., Great Plains, the general ledger system), and reconciliation between the two systems. This could potentially result in additional staff and other resources which would exceed KRS' current budget approved by Kentucky General Assembly.

Auditors' Reply

The APA would like to note that corrective action would not necessarily require maintaining two sets of books. We are not aware of any limitations in eMARS that would prevent KRS from utilizing eMARS as its primary general ledger system. KRS management may also note the added benefit of a cost savings if eMARS is utilized as the sole accounting system.

2013-KRS-04: KRS Did Not Adequately Segregate Duties Related To Fixed Income Transactions

KRS does not have adequate segregation of duties over internal fixed income transactions. One employee has the authority to buy, sell, send trade information to the custodian bank, and reconcile the fixed income accounts. There is no review or approval process in place for these fixed income transactions. While the investment group in general is aware when buying and selling is occurring, there is no documentation of review and approval for transactions.

One employee is especially knowledgeable and KRS relies on the employee's skills for fixed income transactions.

Investments outside KRS policy could be purchased, investments could be sold when not necessary, inaccurate information could be sent to the custodian bank, and reconciliations could contain errors. In short, errors could occur and not be detected. Also, without additional employees responsible for portions of the fixed income investment process, KRS could have problems if the responsible employee resigns or makes an error which could have been prevented by segregating duties.

The objective of segregation of duties is to ensure assigned duties are separated so no one employee is in a position both to commit and conceal errors while performing their assigned duties. Adequate segregation of duties reduces the likelihood that errors, either intentional or unintentional, will remain undetected. This is carried out by providing for separate processing by different individuals at various stages of a transaction and by independent reviews of the work performed.

Recommendation

We recommend KRS ensure duties are segregated so no one person performs all stages of a trade.

Management's Response and Corrective Action Plan

KRS agrees with the finding.

KRS has begun training an Investment Analyst to take over a properly segregated portion of the fixed income trading process.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-05: KRS' Financial Statement Preparation Process Is Not Adequate

During the audit of the Kentucky Retirement Systems, we noted multiple errors relating to the financial statement preparation process and brought these to management's attention. The errors included:

Financial Statement and Journal Voucher Adjustment Errors

1. An error in the calculation for the securities lending collateral journal voucher (JV) for the Insurance Fund resulted in significant adjustments needed to correct each of the plans. Additionally, upon further testing, we noted the securities were not recorded at market value, which resulted in another adjustment, this time for both the pension and insurance funds. Upon being detected by the auditors, the financial statements were adjusted to reflect the correct amounts. The table below summarizes the amount of the change between the original JV and the correction for each plan and in total.

	Dollar Amount of Change Between Original and Final Journal Vouchers					
PENSION FUND	KERS	CERS	SPRS	CHAZ	KHAZ	TOTAL
Assets	$ (102,762,959)	$ 42,513,026	$ 4,000,270	$ 15,648,446	$ 6,778,209	$ (33,823,008)
Liabilities	(102,712,437)	42,620,815	4,004,596	15,681,401	6,786,726	(33,618,899)
Unrealized Gain	(50,523)	(107,789)	(4,326)	(32,954)	(8,517)	(204,109)
INSURANCE FUND	KERS	CERS	SPRS	CHAZ	KHAZ	TOTAL
Assets	(33,886,099)	10,801,930	(809,530)	11,558,254	2,201,427	(10,134,017)
Liabilities	(33,872,603)	10,833,971	(806,632)	11,575,371	2,208,732	(10,061,160)
Unrealized Gain	(13,496)	(32,041)	(2,898)	(17,117)	(7,305)	(72,857)

2. The JV to record quarterly investment expense was created using an estimate from FY12 of $6,086,144, which was based on an estimate from October 2011. The FY13 information indicated actual quarterly investment expenses of $5,908,744, resulting in an overstatement of expenses by an aggregate of $177,400 (note some individual plans were understated while others were overstated). After being noted by the auditor, an adjustment was not made to correct this error on the financial statements.

3. The securities lending investment income amount was overstated by $1,597,555. There was a change in reporting this amount on a monthly basis in FY13; however, the year end JV was not adjusted to reflect that the amount had already been recorded until the auditor made inquiries.

4. The leave balance accrual JV was misstated. Employer retirement rate needed to be updated for the new fiscal year and the rate on the report used for the JV was the previous rate. A manual adjustment was made and no supporting documentation related to the manual adjustment was maintained. On further inquiry, KRS determined the manual adjustment amount was overstated by $23,510. An adjustment was made to correct this error on the financial statements.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-05: KRS' Financial Statement Preparation Process Is Not Adequate (Continued)

5. The June 15, 2013 payroll (paid on July 1, 2013) was not accrued and therefore not included in the FY13 accounts payable balance. Accounts payable was understated by $923,589 at the end of FY13. Further review identified the June 15, 2012 payroll (paid on July 1, 2012) was also not included in the FY12 accounts payable. The FY12 expense should have been an accrual for FY12 and reversed in FY13. An adjustment was made to correct the FY13 financial statements accounts payable balance.

6. For one payment to the Healthcare Claims Paid account, CERS and CHAZ were netted due to CHAZ having a credit balance of $4,665. Netting is acceptable for payment purposes; however, KRS did not create a JV after the payment to correctly record accounts payable between the two plans.

7. KRS draws funds down from the Pension Fund to the General Fund to pay administrative expenses twice a month. At the end of the year any funds drawn down to the General Fund and not expended are returned to the Pension Fund by a JV. The percentage split for allocating the funds to the plans was recorded using the plan allocation percentages for FY12 instead of FY13. This resulted in the accounts receivable for the following individual plans being under or over stated (overstatements are indicated in parenthesis), though the total is not impacted. These adjustments were not made to the financial statements.

	As Recorded (FY12 Allocation)	FY13 Allocation	Difference
KERS	$ 15,187	$ 15,818	$ 631
CERS	25,834	25,301	(532)
SPRS	233	309	76
CHAZ	2,156	2,205	49
KHAZ	1,324	1,100	(224)
Totals	$ 44,734	$ 44,734	$ 0

Notes to the Financial Statement Errors

8. Note B, Plan Description and Contribution Information, Hospital and Medical Contracts for FY12 initially reported information for FY11 in the FY12 column. The column heading had been changed, but the prior year amounts had been left in the column. Several similar situations were noted during our review of the financial statement notes.

9. Note D, Investments, uses multiple reports from the custodian bank to prepare the various schedules. Several reports generated by KRS personnel from the custodian bank information to prepare the schedules were created using incorrect parameters (daily instead of periodic). Thus, schedules in Note D had to be redone using the correct amounts.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-05: KRS' Financial Statement Preparation Process Is Not Adequate (Continued)

KRS changed the notes to the financial statements for the issues above.

Supplementary Information
The Additional Supporting Schedules section of the financial statements includes a Schedule of Direct Investment Expenses related to the Administrative Expense Account. The initial amount reported as Contractual Services-Software for the Pension Fund was $26,000. The amount that should have been reported was $180,000, a difference of $154,000. KRS corrected the Schedule of Investment Expenses to reflect the proper amount.

Auditors noted that KRS staff may create and post a journal entry with little or no review. Therefore, supporting journal entries may not be verified for accuracy prior to being entered into Great Plains. Also, when the draft statements are prepared by KRS, there is no verification the amounts from the prior year are accurate. Finally, there is no tracking method to ensure all year end entries have been completed.

The multiple issues noted with the supporting information and journal entries used to prepare the financial statements and notes indicate the process for year-end financial reporting is not adequate. As a result, the financial statements could be misstated and not detected, resulting in inaccurate information reported. This includes the possibility of individual plan amounts being reported incorrectly.

We are aware that KRS has limited staff in the Division of Accounting; however, it is management's responsibility to ensure strong internal controls are established and functioning. Procedures should be in place to ensure accurate financial statement reporting.

Recommendation

We recommend KRS evaluate the financial statement preparation process to ensure sufficient controls are in place to promote accurate and complete financial reporting that follows applicable accounting standards. The supporting information used to prepare the statements and notes should be evaluated for accuracy prior to use in the financial statements and notes. The supporting information should also be thoroughly and independently reviewed.

Management's Response and Corrective Action Plan

KRS agrees with the Recommendation. With the August transfer of Employer Reporting to another KRS area, the Accounting Division has more time to focus on daily accounting management. KRS will continue to strengthen internal controls and work closely with Internal Audit and the External Auditors. Please note the following specific comments:

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-05: KRS' Financial Statement Preparation Process Is Not Adequate (Continued)

Management's Response and Corrective Action Plan (Continued)

Financial Statement and Journal Voucher Adjustment Errors

1. *KRS agrees with the finding and has made the recommended adjustment. However, the calculation error was due to a formula error in the spreadsheet used to develop an allocation for posting of the securities lending income which is provided as a single amount for pension and insurance. With regards to the market value, KRS staff learned after the adjustment had been made that the report provided by the vendor in the monthly packet was not reported at market value. Vendor then provided KRS with an updated report on which to base the adjustment. This situation was due to a switch in vendor for securities lending activities. The information was provided in total and then had to be segregated between the Pension and Insurance Plans.*
2. *KRS agrees with the finding. The necessary information was not available at the time of posting. Therefore, to remain reasonable and consistent with prior year, the adjustment was continued in current year. Once the current year information was received, the net error of $177,400 was not booked because it was deemed to be immaterial based upon prior audit experience.*
3. *KRS agrees with the finding. In prior years the routine has been to update securities lending income at the end of each fiscal year. However, due to updated reporting provided by the custodian this information was available on a monthly basis for fiscal 2013. As a result of the updated reporting and a delay in updating the year end procedures, related to the custodial bank conversion for securities lending activities, the income was posted twice. The adjustment has been made to correct the overstatement and reflected in the financial statements.*
4. *KRS agrees with the finding. The misstatement was due to an error in the leave liability report provided to accounting. An adjustment of $23,510 was made to correct the error; the leave liability report has been updated to reflect the correct retirement rate.*
5. *KRS agrees with the finding. This was due to relatively new procedures mandated by the Commonwealth of Kentucky to hold the June 30 payroll until July 1 which creates an additional accrual of payroll liability. This accrual has been posted and is reflected in the financial statements.*
6. *KRS agrees with the finding. While the accrual for this payment did not affect the transfer of funds between CERS and CHAZ, the transfer was made after the payment was submitted to the vendor in July 2013. The net balance of $4,665 was deemed immaterial based upon prior audit experience and not posted to fiscal 2013. The appropriate adjustments have been made in the current fiscal year.*
7. *KRS agrees with this finding. The net difference was zero. The largest variance was $631 in KERS. Due to the immateriality of the correction, KRS did not reopen the books for fiscal 2013. The correction has been made in fiscal 2014.*

2013-KRS-05: KRS' Financial Statement Preparation Process Is Not Adequate (Continued)

Management's Response and Corrective Action Plan (Continued)

Notes to the Financial Statement Errors

8. *Note B [Plan Descriptions and Contribution Information]: KRS agrees with this finding. The roll forward document prepared by the FY12 CPA firm did not update the column headings. KRS will work with the future external auditor to ensure that roll forward document is accurate. Note D [Investments]: KRS agrees with this finding. Information has been updated.*

Supplementary Information

9. *KRS agrees with this finding. While the overall investment expense agreed to the financial statements, the above referenced expenses were misclassified within the Schedule. Schedules have been updated.*

2013-KRS-06: KRS Did Not Ensure Access To Its Pension Administration And Accounting Systems Was Appropriate

Our Fiscal Year (FY) 2013 audit of Kentucky Retirement Systems (KRS) revealed weaknesses related to security surrounding the Strategic Technology Advancements for the Retirement of Tomorrow (START) and Great Plains systems. Our review found instances where sufficient documentation was not maintained for new employees or employees that transferred to new positions within KRS to support access requested and granted to START and Great Plains. In addition, we identified individuals who were no longer employed with KRS, but retained access to START or Great Plains. Further, KRS allows requests for access to be cloned or mirrored from existing users, but does not specifically document access rights granted.

KRS has established an informal process that requires either a completed Problem Incident Report (PIR) or service desk ticket, which is logged within the Front Range tracking system, to be provided in order for access to be granted to KRS systems. Actions allowed within these systems are determined based on the assigned security role.

In relation to START, we initially tested 11 of the 268 user accounts with access to the system to ensure adequate documentation was on file to support the security roles granted to these users. Our examination revealed the following issues:

- One of the 11 sampled users, or 9.1 percent, was found to no longer be employed with KRS. However, the individual's START access was not removed at that time; instead it was removed in response to our audit review, which was 10 months after separation.
- Three of the 11 sampled users, or 27.3 percent, were found to have a FrontRange ticket identifying that these individuals were being transferred to another position or business section within KRS. However, there was not sufficient information within the ticket to support the START access rights granted to correspond to the transfer in job duties.
- Two of the 11 sampled users, or 18.2 percent, were found to have a PIR on file requesting access be established to clone or mirror another staff member. There was no documentation retained of the referred staff member's access rights at the time of the request or the particular rights granted to the individual in response to this request.

Based on the identification of an individual retaining access to the START application after separating employment from KRS, we further tested accounts with access to the START application at the time of fieldwork and found the following issues:

- Two of 11 individuals identified as having separated employment with KRS during FY 2013, or 18.2 percent, were found to still have access rights to START at the time of fieldwork. Access was removed in response to our audit review.
- Two additional active user accounts were associated with individuals who were no longer employed by KRS. As a result of our audit review, KRS removed the access for these accounts, which was 16 and 20 months after separation, respectively.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-06: KRS Did Not Ensure Access To Its Pension Administration And Accounting Systems Was Appropriate (Continued)

In regards to Great Plains, we tested four of the 42 user accounts with access to the system to ensure adequate documentation was on file to support the security roles granted to these users. Our examination revealed one of the four sampled users, or 25 percent, had a PIR on file requesting access be established to clone or mirror another staff member. No documentation was retained of the referred staff member's access rights at the time of the request or the particular rights granted to the individual in response to this request. Further, based on our request for information, KRS identified that 14 of the 42 individual user accounts, inclusive of one of our sampled users, no longer required access to Great Plains. Access for these accounts was removed during fieldwork.

We would like to acknowledge that KRS staff was proactive and ensured each of the issues identified during fieldwork were properly resolved. However, given the number of issues KRS corrected during testing, it appears that KRS did not consistently comply with their Access Control Policy which requires the review of established user accounts and ensuring inactive accounts within business applications are disabled or deleted on a regular basis.

Failure to consistently apply logical security controls could result in the exposure of data and system resources to unauthorized or inappropriate access. This situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, and inappropriate or illegal use of system resources.

Logical security controls must be consistently applied to ensure unauthorized individuals are not allowed access to a system. As specifically stated within the KRS Access Control Policy, "KRS shall restrict access to systems and business application to only those individuals who have a business need to access those resources in the performance of assigned official duties." Access rights should be periodically reviewed to ensure that access is still required by users. Within the KRS Access Control Policy, it states "KRS shall review user accounts periodically and disable accounts that have been inactive for more than 30 days and delete accounts that have been inactive after 60 days, with the exception of accounts belonging to individuals with approved leave of absences."

Recommendation

We recommend KRS adhere to established informal procedures until a security policy can be developed and implemented to ensure only authorized users are granted access to START and Great Plains. KRS should ensure all requests for access are submitted through a PIR and maintained within the Front Range tracking application. All necessary supporting documentation should be obtained and properly retained within the Front Range application or attached to the PIR. This documentation should, at a minimum, include a detailed listing of all access rights being requested for the individual or, in the case of a mirrored or cloned access request, the referred staff member's access rights at the time of the request.

2013-KRS-06: KRS Did Not Ensure Access To Its Pension Administration And Accounting Systems Was Appropriate (Continued)

Recommendation (Continued)

We also recommend KRS provide security access training to Human Resource staff and other managers responsible for requesting system access to ensure all are aware of the required documentation necessary to grant access to START and Great Plains. In addition, staff should be made aware of the documentation needed and actions required for employees that transfer within KRS or terminate employment.

Further, we recommend KRS implement a formal review process to ensure all user accounts with access to START and Great Plains are needed. As denoted within the KRS Access Control Policy, this review should identify all user accounts that are inactive for more than 30 days. All affected accounts should be specifically addressed with management and the access should be removed or disabled if the access is determined to no longer be needed. This review should be performed by management on a regular basis and actions taken should be documented for audit purposes.

Management's Response and Corrective Action Plan

KRS agrees with this finding. We have provided awareness and education to management team members regarding the setup of new employees and employees that have transferred internally in a manner than provides least privilege. Additionally, we have provided management, including Human Resources staff with education regarding employees that leave the organization.

During March, April and May of 2013 we have required every employee and manager to attend a SANS online training course, Securing the Human, and answer test questions at the end of each segment of the training. Training consisted of up to 36 modules, including training relevant to this finding. We plan to begin security training again for all employees and managers in December, 2013 to ensure that staff fully understands risks and their responsibilities.

Additionally, KRS will update our existing Access Control Policy to ensure it is clear that the policy issues identified are also applicable to all systems, including START and Great Plains. We will include your recommendations for policy components.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-07: KRS Did Not Properly Secure And Segregate Administrator Access Rights To Great Plains

Our Fiscal Year (FY) 2013 audit of Kentucky Retirement Systems (KRS) revealed they did not employ adequate security and segregation of duty controls between the administration and data processing functions for the Great Plains application. Specifically, the administrator account was used as a group account by three different employees. Discussions with KRS revealed this group account was disabled on April 21, 2013 and was replaced with separate alias accounts with administrator rights for each of these three employees.

Further, the administrator account was setup as a Poweruser, which means it had full access to the Great Plains application. The three alias administrator accounts were also established with Poweruser access rights. Our testing revealed that one of these users also has an additional individual user account that allows him the ability to perform financial tasks.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files and programs, and decreases the likelihood of errors or losses occurring because of incorrect or unauthorized use of data, programs, and other resources. Lack of segregation of duties as it relates to Great Plains could enable the perpetration and concealment of fraudulent payroll or accounting transactions.

Shared accounts limit the ability to track user activity by individual, which is even more significant for privileged accounts. Application administrators should not have access to financial transactions since this combination of access rights could allow them the ability to create and approve transactions within the system and, potentially, override controls in place to restrict this type of access.

Recommendation

We recommend KRS perform a review of the security rights established for each of the administrators to ensure these are appropriate based on their job duties. Administrator access should be limited to ensure adequate security over the Great Plains application.

Management's Response and Corrective Action Plan

KRS agrees with this finding. KRS IT management began work to remedy these issues immediately upon identifying them as part of the APA audit. We did a comprehensive review of rights to ensure that there were not additional issues with elevated and/or administrator privileges.

The KRS IT management will review administrator accounts on a regular basis to ensure compliance with our policies and appropriate activity monitoring.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-08: KRS' Process For Waiving Penalties Associated With Late Employer Contributions Is Not Adequate

During the FY13 audit of Kentucky Retirement Systems, we reviewed the process for waiving penalties associated with late employer contributions. We noted the following:

- Penalty amounts are based on the greater of 8% of the contributions owed to KRS or $1,000 so the amount of penalty cannot be calculated until the amount of the contribution is known and penalty invoices are not issued until after the contributions and reports are received. The penalty amount should be compounded annually based on the contribution amount due. On penalty invoices the interest is based upon one month's interest and does not take into consideration the amount of time report is delinquent.
- The Controller is the only person authorized to waive penalties. Since the implementation of the START system in FY12, many penalty invoices were waived because employers could not file the report on time due to technical difficulties. Adequate documentation of which employers had penalties waived and why was not maintained.
- Other KRS personnel could remove the penalty in the START system and notate per controller with no other form of supporting documentation. We reviewed 14 penalty invoices and six did not have documentation of waiver approval.
- There are no written procedures in place for the issuance, waiver, and collection of penalties. KRS could not provide a list of allowable reasons justifying waiver of penalties nor did the START system note any justification.
- The Delinquent Employer Report we requested for December 31, 2012 was not available because it had not been printed and retained. START cannot generate a historical report of delinquent employers for specific dates.

By not considering how long a contribution payment is delinquent, the penalty invoices are not charging the correct amount of interest for employers who pay late. Thus, KRS is not receiving all interest due from employers.

There is a segregation of duties issue since the controller was the only employee authorized to waive penalties in FY13. However, the assistant controller is now also authorized to waive penalties.

There is no documentation of which penalties were waived, by whom, or why the penalty was waived. Unauthorized employees could waive penalties in the system and simply indicate per controller in the note portion of START. Penalties could be waived without prior approval of the Controller.

Well-defined policies and procedures related to penalties and interest have not been established. In order to be fair and consistent among employers who make late contribution payments, a list of allowable reasons for waiving penalties should be established.

2013-KRS-08: KRS' Process For Waiving Penalties Associated With Late Employer Contributions Is Not Adequate (Continued)

Historical reports for employers submitting late payments from START cannot be reproduced. If information related to delinquent employers is required, KRS personnel can only go in to specific employers. There is no way to review historical reports of delinquent employers, unless a report was printed and maintained previously.

Per Kentucky Revised Statute 78.625:

> If the agency reporting official fails to file at the retirement office all contributions and reports on or before the tenth day of the month following the period being reported, interest on the delinquent contributions at the actuarial rate adopted by the board compounded annually, but not less than one thousand ($1000), shall be added to the amount due the system.

The objective of segregation of duties is to ensure assigned duties are separated so no one employee is in a position both to commit and conceal errors while performing their assigned duties. Adequate segregation of duties reduces the likelihood that errors, wither intentional or unintentional, will remain undetected. This is carried out by providing for separate processing by different individuals at various stages of a transaction and by independent reviews of the work performed.

Good internal controls dictate KRS should have adequate controls and documentation over who waives penalties and the reasons for the waivers. Unauthorized employees should not be able to waive penalties. Written policies and procedures should provide guidance to employees and management on the issuance, waiver, and collection of penalties. Written policies and procedures help prevent mistakes and ensure compliance and consistency.

KRS should be able to track delinquent employers using historical reports in START without maintaining hardcopies of the reports.

Recommendation

We recommend KRS:

- Update the START system for annual compounding of penalties and interest.
- Consider having the Controller provide reports of penalties waived to the Executive Director and the Audit Committee.
- Update the accounting manual to include policies and procedures manual to include penalty and interest procedures.
- Update START system for retention of delinquent employer reports.

2013-KRS-08: KRS' Process For Waiving Penalties Associated With Late Employer Contributions Is Not Adequate (Continued)

Management's Response and Corrective Action Plan

KRS agrees with this finding.

Prior to START, delinquent employers were billed $1,000 regardless of the amount of delinquent contributions. With the implementation of START, a penalty charge was assessed at 8% annually or $1,000, whichever is greater. However, KRS 61.675 and KRS 78.625 do contain language regarding annual compounding of penalties and interest. KRS' Legal Department will review and make recommendations for compliance.

Note: Analysis of the May 2013 report month indicated that 2.59% of the 1,312 employers were delinquent. 2.1% of all employers were delinquent but submitted their reporting within 30 days and would not have been impacted by a change in methodology to annual compounding of penalties and interest. A change in methodology to annual compounding of penalties and interest would have impacted three employers, or 0.2287% of total employers reporting to KRS.

The Controller is authorized to waive penalties. The Controller will compile and present a quarterly report to the Executive Director, Chief Operations Officer, and Audit Committee, which will document reasons for penalty waivers. The Accounting Division Policy and Procedures Manual will be updated to reflect penalty and interest procedures. Additionally, journal comments in START will be utilized to denote penalty waivers.

START does not have a standard month end report (ex. 12/31/2012). On a weekly basis, Employer Compliance reports are prepared by IT and distributed to management for review. This includes the Outstanding Employer Delinquencies report. These reports are retained and used for historical employer delinquency analysis. KRS will consider future START reporting enhancements.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-09: KRS Quarterly And Year End Accounts Receivable Process Does Not Report Receivables Accurately

During the FY13 audit of Kentucky Retirement Systems, we reviewed the accounts receivable by plan recorded in Great Plains, the accounting system used by KRS. We found the following:

- The Installment Purchase Service (IPS) Agreement balances were recorded using the August 12, 2011 Installment Purchase System Payoff Amounts Report from the prior computer system instead of the Strategic Technology Advancements for the Retirement of Tomorrow (START) system, implemented in September 2011. IPS Agreements occur when eligible members purchase service time towards retirement and make installment payments. We compared a START query to Great Plains and accounts receivable is overstated by $5,206,554.
- Any penalties owed to KRS for late payment of contributions by employers should appear on quarterly financial statements. However, the methodology for recording the contributions receivable estimate does not account for delinquent balances. For example, employer's contributions not paid timely are left out of the quarterly accrual calculation.
- There are no written procedures related to recording quarterly accounts receivables.

START records all contributions and benefit payments. The August 12, 2011 data from the prior system was used to record the IPS Receivables until the work orders for the IPS portion of the system could be completed.

Contributions receivable is estimated based upon the prior month's contributions. This method assumes all contributions have been submitted for the prior month. If contributions are not submitted timely, the contribution amount is not included in the estimate. The written procedures in the Division of Accounting do not include accounts receivable processes.

Payments are made monthly on IPS contracts by participants. There have been 22 months worth of payments made toward this balance as of June 30, 2013 as well as new IPS contracts initiated since the implementation of START causing the receivable balance to be misstated. The amount recorded from August 2011 is $11,698,068 when the June 30, 2013 IPS contract balance is $6,491,514. This creates a receivables overstatement of $5,206,554. KRS indicated this is an estimate and did not adjust the FY 13 financial statements, but plan to post a new estimate in Great Plains in FY 14.

The accounts receivable balance for a specific month is understated by the penalty amount due from the employer because the penalty is not assessed until after the employer contribution is paid. The accounts receivable balance at year end will not include penalties assessed for delinquent employers. While the penalty is based on the amount owed by each employer, a reasonable estimate of the amount owed should be calculated. When contributions receivables are based upon the prior month's contributions submitted, the estimate does not account for the delinquent accounts since the moneys have not been received. This could cause an over or under-statement of receivables. For example, if an agency has

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-09: KRS Quarterly And Year End Accounts Receivable Process Does Not Report Receivables Accurately (Continued)

not paid contributions, not only the current month's contributions are due but also the prior month. This would understate the receivable. However if the agency pays more than one month's contributions in the prior month, the receivable would be overstated. The lack of written procedures could result in errors in the absence of knowledgeable staff.

Good internal controls dictate:

- Estimates should be reasonable and based on the most current available information.
- Accounting policy manuals are in place to ensure proper accounting principles are applied and transactions are treated consistently. Written policies and procedures help prevent mistakes, ensure consistent treatment of transactions, and assist in providing staff training.

Recommendation

We recommend KRS:

- Use current balance data for recording the IPS receivable balance.
- Account for delinquent contributions when estimating and recording the contributions receivable balances.
- Develop written procedures for processing accounts receivable.

Management's Response and Corrective Action Plan

KRS agrees with this finding.

In fiscal 2014, the accrual amounts have been updated. In addition, management will develop specific written procedures for the posting and accrual of employer/member contributions. Delinquent contributions will be reviewed as part of the accrual process.

Management will review the employer delinquent list to determine the estimated delinquent amount to be accrued.

Management will update the Accounting Division Policy and Procedures Manual accordingly.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-10: KRS Did Not Classify Intangible Assets Correctly

During the audit of Kentucky Retirement Systems, we noted intangible assets and amortization increased significantly over the prior year in the draft financial statements.

	FY12	FY13	Change
Intangible Assets	$12,724,117	$16,254,290	$3,530,173
Accumulated Amortization	2,893,011	4,059,389	1,166,377

We reviewed the support for the increase in the intangible asset balance for FY13 and noted the following:

1. The supporting documentation for the intangible assets included one invoice item for $300,469 reported as an intangible asset which should have been reported as computer equipment.
2. Two employees' travel for START training, totaling $3,796, was included as an intangible asset. These expenses are not considered intangible assets and should have been expensed when incurred.
3. There was an unexplained difference between the invoices reviewed and the intangible asset total for FY13 of $11,913.

We also reviewed the Intangible Asset Note to the financial statements. The note reported amortization for FY13 of $2,406,961, which did not agree to the amortization amount indicated on the financial statements. In addition, the journal entry to record the June 2013 amortization of $106,034 was recorded in FY14.

Errors were made in classifying the expenditures as intangible assets. Thus the financial statements are not accurate for Equipment (net of accumulated depreciation) and Intangible Assets (net of accumulated amortization) line items.

There was a journal entry of $1,240,584 titled "Capitalization of START Costs" for the KERS Amortization Expense account that was incorrectly included in the calculation. KRS immediately backed this amount out of the Amortization Expense account upon the auditors' inquiry. In addition, the monthly amortization amount of $106,034 (which is allocated among the five retirement plans) for June was posted in FY14. The amortization reported in the Note to the financial statements for FY13 should be $1,272,411 (2,406,961 less $1,240,584 plus $106,034). Therefore, the Statement of Net Position – Pension Amortization Expense is understated by $106,034.

GASB 51, Accounting and Financial Reporting for Intangible Assets defines an intangible asset as an asset that lacks a physical substance, is nonfinancial in nature, and has an initial useful life extending beyond a single reporting period. This applies to the START software, but not to the hardware (computer equipment) used for the START system.

2013-KRS-10: KRS Did Not Classify Intangible Assets Correctly (Continued)

Per GASB Statement 51, paragraph 13, "Outlays associated with activities in the post-implementation/operation stage should be expensed as incurred." Paragraph 10 c. explains that activities in the post implementation stage "include application training and software maintenance."

Recommendation

We recommend KRS:

- Adjust the intangible assets and equipment accounts for FY14.
- Review procedures for classifying items as intangible.
- Determine if amortization is being calculated accurately by the Great Plains system.
- Implement year end procedures, or a checklist to ensure appropriate journal entries are made into the correct Great Plains accounts.

Management's Response and Corrective Action Plan

KRS agrees with the finding.

When the original footnote disclosure regarding the intangible assets was prepared for DRAFT purposes, not all information was available. However, this amount has been corrected and updated for accurate footnote disclosure. In addition, the fixed and intangible assets have been adjusted for fiscal 2014.

Currently, KRS reviews all fixed and intangible asset expenditures at the end of each fiscal year. Those items that meet the capitalization policy requirements are then capitalized to the appropriate category. As a result, depreciation and amortization are calculated in the next fiscal year since the items were capitalized as of June 30 of each fiscal year.

KRS will review its procedures for classifying fixed and intangible assets to the appropriate category as well as investigate the programming of the Great Plains General Ledger System to ensure that it is programmed appropriately to calculate depreciation and amortization expenses. Also as an additional control, KRS will develop a year end checklist to ensure that the appropriate general journal entries are posted to the correct general ledger accounts.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-11: KRS Does Not Have Procedures Established To Ensure Investments Are Recorded In The Proper Accounting Period

During the FY 13 Kentucky Retirement System (KRS) audit, we noticed the custodian bank's Custom Report for Kentucky Employee Retirement System Nonhazardous (KERS) Insurance had a negative cash balance of $5,794,242. The cash was negative due to an investment purchased and recorded at the custodian bank on June 28, 2013 for $46,150,000. However, the investment was not allocated to all the individual plans until the following business day, July 1, 2013. This resulted in the Custom Report for June 30, which is used to prepare the financial statements, being inaccurate.

KRS' Division of Accounting should ensure controls are in place at year end to properly record investment transactions in the accounting system. If the transaction amount had been small, the timing difference would not have been identified and the investments recorded on the financial statements for June 30 would have been inaccurate.

It is the custodian bank's normal procedure for purchases to be held in one fund (such as KERS) until the following day when the purchase is allocated to the individual plans (State Police Retirement System, KERS Hazardous, etc). KRS does not have procedures in place to determine if investment transactions are recorded in the correct fiscal year. KRS relies on the Custodian Bank to record investments and investment income in the correct fiscal year.

The Custodian Bank corrected their records to properly record the transaction and show the appropriate split which resolved the negative cash in the KERS plan for FY 13. The timing difference noted above would have impacted the financial statements by recording the cash expended to make the purchase in KERS plan alone with no funds being shown as removed from the other plans. It would also not record the investment as an asset due to the delay in recording.

KRS should have internal controls in place to ensure recording of investments in the proper fiscal year without relying only on a third party. Investments should be recorded in the correct plan and fiscal year.

Recommendation

We recommend KRS review their year-end processes and implement controls to ensure investments are recorded in the correct year and plan.

Management's Response and Corrective Action Plan

KRS agrees with the finding.

The negative cash balance was a result of the Division of Investments funding a new manager during the latter part of June 2013 and all transactions related to that funding had not yet settled as of June 30, 2013. The final transaction settlement was posted on July 1, 2013, but has been

2013-KRS-11: KRS Does Not Have Procedures Established To Ensure Investments Are Recorded In The Proper Accounting Period

Management's Response and Corrective Action Plan (Continued)

updated to be reflected in fiscal 2013 financial statements. While the funding of a manager is a routine process, it is unusual for this to occur at the end of the fiscal year. Despite this negative cash balance, there was no overdraft of cash. This was merely a bookkeeping transaction that was awaiting final allocation. Management will confer with the Division of Investments prior to posting any investment data to the general ledger system.

Management will update the Accounting Division Policy and Procedures Manual to include investments in the approval process for the monthly recording of investment activity.

2013-KRS-12: KRS Does Not Have An Adequate Contract Monitoring Process

During the FY13 audit of Kentucky Retirement Systems, we reviewed the contract process. KRS does not have a central listing of all contracts on which expenditures are paid. The directors of the respective business units are responsible for procuring, maintaining, and monitoring the contract as well as tracking the expenditures. Our review noted the following:

- We requested a complete listing of contracts from the Division of Accounting and were referred to the Division of Legal Services. After receiving the listing, we ran an eMARS report and realized the list did not include contracts with the Division of Procurement, the Division of Investments, and the Division of Information Technology.
- Using the eMARS report and KRS contract listing, we requested 12 contracts to review. KRS was unable to locate three contracts procured for FY2013. One contract was subsequently located; however the two additional contracts expired in FY 2012 and the result was $171,197.22 in payments to medical examiners without contracts in place.
- KRS has policies in place for awarding contracts; however, there is no procedure manual documenting how contracts are paid, tracked, and monitored after the award.

The contracts are not tracked and monitored through a central location. The Division of Accounting pays the invoices for the contracts that are received but does not obtain the contract to ensure the payment is allowable or appropriate. Although the majority of the contracts reviewed did not have a maximum payment ceiling, the Division of Accounting would be unable to determine if the contract was overspent.

Good internal controls dictate KRS establish and monitor its policies to ensure all contracts are reviewed and renegotiated as needed (or required by contract), including establishing a method to track contracts and ensure all contractual payments relate to valid contracts.

Recommendation

We recommend KRS:

- Implement a centralized process for tracking contracts, such as manually tracking via an excel spreadsheet or using the capabilities in eMARS.
- Document the contract process in the Division of Accounting policy and procedure manual and send a memo to business unit directors to ensure awareness of contract responsibilities.

Management's Response and Corrective Action Plan

KRS agrees with this finding.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-12: KRS Does Not Have An Adequate Contract Monitoring Process (Continued)

Management's Response and Corrective Action Plan (Continued)

KRS agrees that having a centralized repository of all KRS initiated contracts would be a control enhancement. Our Legal department will develop and maintain the contract log in Excel (vendor name, annual contract amount, total contract value, time period of contract, and brief description). In July 2013, our KRS Accounting area implemented a payment tracking process that lists all monthly expenses by general ledger account #, date paid, vendor/payee name, amount, and description. This information is provided to the business unit directors for review. This information can be cross-referenced to the contract log maintained by the Legal department. Additionally, we will update the Accounting Division Policy and Procedures Manual to reflect this process.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-13: KRS Does Not Document Notifications To Delinquent Employers Nor Notify Members Of Delinquent Installment Service Purchase Payments

During the FY13 audit of Kentucky Retirement System, we reviewed the process for handling delinquent accounts. Employers are required to submit a three part submission by the 10^{th} of the month following the active participant payroll. The Strategic Technology Advancements for the Retirement of Tomorrow (START) system notifies the employer via e-mail around the 7^{th} when either one or all parts of the submission have not been received. In addition, the delinquent agency is contacted via phone after the 10^{th} deadline. We found:

- The START system does not store the employer's e-mail notification.
- Members are not notified of delinquencies on installment payments towards the purchase of service time.

The START system is not set up to provide an audit trail to ensure employers and members are notified of delinquencies. Since there is no evidence delinquent employers are notified of funds due, an employer may have a penalty for late payment waived by claiming they were not notified, even if they were. Members with delinquent installment payments may not be aware their payment is late.

Good internal controls require documentation that employers are made aware, prior to an actual delinquency, that there is a problem with their reports. Members should also be informed if there is a delinquency so the problem can be corrected with a minimum of penalty and interest charged.

Recommendation

We recommend KRS:

- Store all automatic emails sent to employers.
- Notify members of delinquent installment payments.

Management's Response and Corrective Action Plan

KRS agrees to review the processes used to document the notification of delinquencies to both members and employers.

KRS does not plan to store all automatic emails sent to employers in the START imaging system. The majority of these emails are generic in nature and do not give specific information. KRS will explore the possibility of enhancing START functionality to provide an audit log of the automatic delinquency emails sent to employers.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-13: KRS Does Not Document Notifications To Delinquent Employers Nor Notify Members Of Delinquent Installment Service Purchase Payments (Continued)

Management's Response and Corrective Action Plan (Continued)

KRS does not notify members of delinquent IPS payments because they are submitted by the employers through payroll deduction and the monthly reporting process. The majority of the IPS delinquencies are due to issues stemming from KHRIS System implementation. Currently, accounting staff members are personally contacting employers to notify them of IPS delinquencies. A log will be kept for documentation of those contacts. START does have a reporting module that would provide employers a monthly report of any delinquent IPS payments. KRS will assess the progress made in the KHRIS employer reporting file, and determine the best date to begin including this report in the employer monthly packet.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-14: KRS Did Not Complete Monthly Fixed Income Reconciliations For Seven Months During Fiscal Year 2013

During the FY13 audit, we inquired about reconciliations between KRS directors and the custodian bank. For transactions completed by KRS directors and staff, reconciliations to the custodian bank are supposed to be completed monthly. However, the reconciliations for fixed income investments were not completed for the seven month period from December 2012 to June 2013. KRS immediately completed the reconciliations in FY14 after the auditor requested the reconciliations and KRS realized they were not done.

In addition, KRS does not document if the reconciliations are reviewed or when the review is completed. There are no written policies or procedures related to the reconciliations.

The employee who prepared the fixed income reconciliations transferred to a new position and no one was assigned responsibility for completing the fixed income reconciliations. Errors could have occurred and remained undetected during the time the fixed income reconciliations were not completed. Reviewing the reconciliations would detect any errors made by the preparer; however, there is no way to determine if and when the reconciliation was reviewed.

There are no written policies or procedures documenting the reconciliation process. Written procedures are a mechanism to address turnover situations and document employee responsibilities and how employees accomplish their tasks, such as reconciliations.

Good internal controls dictate reconciliations should be performed and reconciliation reviews documented to reduce the chance of errors which could impact the financial statements. Written procedures should be in place to prevent lapses of job responsibilities during times of employee turnover.

Recommendation

We recommend:

- KRS initiate a review and sign off process on the monthly fixed income reconciliations.
- The Division of Investments prepare written procedures or policies to document the reconciliation process.

Management's Response and Corrective Action Plan

KRS agrees with the finding.

KRS will prepare written policies and procedures to document the reconciliation process including the initiation of a review and sign off process for the monthly fixed income reconciliations.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-15: The Accuracy Of The Plan Splits For The Administrative Budget Cannot Be Verified

During the FY13 audit, we reviewed the process for recording administrative expenses across the five retirement plans. Funds are drawn down from the pension fund at the custodial bank twice a month for payment of administrative expenses based upon KRS' annual budget. These funds are split between the five retirement plans based on the prior fiscal year's total number of participants in the plans. We found the following:

- One of the six administrative transfers reviewed did not have the correct split applied. This resulted in KERS (Kentucky Employee Retirement System) Non-Hazardous being under charged for administrative expenses by $14,100, SPRS undercharged by $1,700, CERS (County Employee Retirement System) Non-Hazardous overcharged by $4,700, CERS Hazardous overcharged by $6,100, and KERS Hazardous overcharged by $5,000.

- The plan split used was based on the FY12 plan participation from the financial statements; however the plan participation in the FY12 Comprehensive Annual Financial Report (CAFR) differs from the financial statements. The financial statements are issued by an independent auditor and the CAFR is issued by KRS. The overall participation is the same in both the financial statements and the CAFR; however, we noted differences between the Hazardous and Non-Hazardous participation counts. Based on the FY12 CAFR, FY12 Financial Statements, and FY13 administrative budget, the differences and their potential impact are as follows:

	Number of Participants			
	CAFR	Financial Statements	Difference in Number of Participants	Dollar Impact Based on FY 13 Budget
KERS	117,589	118,163	(574)	$(65,017)
KHAZ	8,784	8,210	574	65,017
CERS	189,006	191,411	(2,405)	(275,364)
CHAZ	16,467	14,062	2,405	275,364
SPRS	2,331	2,331	0	0
Total	334,177	334,177	0	$0

In essence, the administrative budget for CERS and KERS was less by using the number of participants reported in the CAFR instead of the number of participants reported on the financial statements to calculate the plan splits, while CHAZ and KHAZ were more. We cannot determine which participant count is accurate.

2013-KRS-15: The Accuracy Of The Plan Splits For The Administrative Budget Cannot Be Verified (Continued)

The administrative transfer documentation does not indicate a thorough review was completed by KRS personnel. Administrative expenses were not properly allocated to the individual plans. We inquired with KRS' management who indicated the CAFR information came from the actuary. Then, we inquired of the actuary and they indicated the information came from KRS. Although the dollar impact is immaterial for FY13 for both plan split issues, the difference in the plan split could cause a material misstatement in the financial statements.

Good internal controls dictate the administrative transfers should apply the correct plan splits. In addition, the participant counts reported in the financial statements (prepared by an independent auditor) should agree to the Comprehensive Annual Financial Report.

Recommendation

We recommend KRS ensure:

- The review of administrative transfers includes verification the correct plan splits were used.
- The CAFR plan member participation counts agree to the financial statement member participation counts.

Management's Response and Corrective Action Plan

KRS agrees with this finding.

The Administrative Allocation is based upon the member by system report which was pulled on August 24, 2013. In early September 2013, the report was updated with Problem Incident Request (PIR) 16713 for CAFR reporting. However, the updates made with PIR 16713 was not reflected in the Administrative Allocation. Staff will work to ensure any updates made are communicated to all who depend on the reported information.

A correction (CMTRX#00012391) has been made to move funds from KHAZ to KERS in the amount of $65,017 and also a correction to move funds from CHAZ to CERS in the amount of $275,364 in fiscal 2014. The financial impact to fiscal 2013 amounts to 0.1% in the K plans and 0.7% in the C plans, both of which are immaterial, based upon prior audit experience.

2013-KRS-16: KRS Is Not Performing All Post-Retirement Audits Of Retiree Accounts

During the FY13 audit of Kentucky Retirement Systems, we found post-retirement audits of retiree accounts are not being performed. In September 2011, KRS implemented new computer software, Strategic Technology Advancements for the Retirement of Tomorrow (START). This system was designed to lessen the manual workload in many areas, including retirement audits. Prior to START each retirement account had a post-retirement audit performed roughly three months following the employee's retirement to allow for the posting of all employer activity to ensure the retiree receives the accurate benefit amount. The START system has a feature built in to check for discrepancies between the original reported compensation and the final reported compensation; however this function has yet to be utilized for logistical reasons.

At the time START was implemented, there was a backlog of approximately 500 retirements needing post-retirement audits. No post-retirement audits have been completed since the implementation of START, unless a member has called requesting the audit.

The START system requires employers to report much more detailed information than was previously required. Due to this requirement as well as the Kentucky Human Resource Information System (KHRIS) system (the payroll system used by the Commonwealth of Kentucky) not fully communicating with the START system, KRS employees must manually edit many of the reports submitted. Since KRS is still experiencing a high volume of manual edits, KRS staff members who would normally perform post-retirement audits are occupied making sure the information sent from employers is accepted by START.

Retiree benefits could be inaccurate if post-retirement audits are not performed and the retiree account adjusted timely. The retiree could be receiving an under or over payments until the account is reviewed and adjusted for information received from the employer after the member retired. The retirees who have not received post retirement audits could owe KRS a large refund or vice versa in the two years since START was implemented.

While internal controls are established to ensure all retirees receive accurate benefit payments, the internal controls are not currently operational related to post retirement audits. Post retirement audits of all retiree accounts are an integral part of a good internal control system. The START Process Retirement Recalculations section of the START manual states:

> The member's account will be evaluated 3 months following Retirement Date to determine:
>
> - A non-zero balance exists because of a difference in Final Compensation / Wages / Contributions
> - Change in Final Compensation / Wages / Contributions
> - Change in Social Security Estimate

2013-KRS-16: KRS Is Not Performing All Post-Retirement Audits Of Retiree Accounts (Continued)

Recommendation

We recommend KRS take steps to reduce the backlog of 500 post-retirement audits and implement the START feature to check for discrepancies between the original reported compensation and the final reported compensation.

Management's Response and Corrective Action Plan

The finding above indicates "no post-retirement audits have been completed since the implementation of START, unless a member has called requesting the audit." However, at the time START was implemented, August 27, 2011, there was a backlog of approximately 2,900 legacy retirements needing post-retirement audits. Approximately 2,500 legacy post-retirement audits have been completed since that time. The current backlog has been reduced to less than 400. Approximately 1,000 post-retirement recalculations on START retirements have been completed as well. All of the remaining legacy audits are associated with the KHRIS System implementation.

The Division of Member Services has redeployed staff and has a dedicated team to work solely on legacy post-retirement audits. We anticipate the remaining legacy audits will be completed by the end of the year. At that time, the focus will shift to non-zero balance account reviews and the recalculation requests that will be generated as a result of the Non-Zero Balance (NZB) report. KRS is testing the NZB report and plans to implement upon completion of the testing. In June 2013, KRS staff worked with KHRIS representatives to establish a process that allowed us to move forward with completing those remaining legacy audits.

KRS will continue to monitor and reduce the backlog of post-retirement audits.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-17: Federal Taxes Were Not Properly Withheld From Refunds

During the FY2013 audit of Kentucky Retirement Systems (KRS), we reviewed refunds of member contributions. If a member is ineligible to retire at the time employment is terminated, the member can receive a refund of their account balance and any accumulated interest. Refunds can be rolled over into another qualified retirement plan or paid directly to the member. We found eleven of the 60 refunds reviewed did not properly withhold the required federal tax.

Refunds cannot be completed until 45 days after the last day of employment. The 45 day period allows for any adjustments from the employer to be made prior to the refund check being sent to the member. Members whose former employer did not send contributions or adjustments timely may have additional fund due after the refund has been sent to the member.

The refund checks did not have the proper federal taxes withheld. Members have additional taxes due that were not withheld as required. KRS is not in compliance with IRS Publication 15-A. Although, the amounts are not material a control weakness and compliance issue still exists.

From IRS Publication 15-A:

> Distributions from eligible retirement plans, such as qualified pension or annuity plans, 401(k) pension plans, section 457(b) plans maintained by a governmental employer, or tax-sheltered annuities that are eligible to be rolled over tax free to an IRA or another eligible retirement plan, are subject to a flat 20% withholding rate. The 20% withholding rate is required and a recipient cannot choose to have less federal income tax withheld from eligible rollover distributions. However, you should not withhold federal income tax if the entire distribution is transferred in a direct rollover to a traditional IRA, or another eligible retirement plan such as a qualified pension plan, governmental section 457(b) plan, or section 403(b) contract or tax-sheltered annuity.

Recommendation

We recommend KRS evaluate the options for correcting the issue within the START system or establish alternative procedures to ensure the correct amount of federal taxes are withheld.

Management's Response and Corrective Action Plan

KRS agrees with the finding and will seek guidance from external legal counsel.

The 20% federal tax withholding did not occur for ten (10) of the eleven (11) audited refunds. However, for one of the audited accounts, the member elected to rollover the portion subject to taxation into a qualified plan so the 20% withholding was correctly not withheld. For the

2013-KRS-17: Federal Taxes Were Not Properly Withheld From Refunds (Continued)

Management's Response and Corrective Action Plan (Continued)

remaining ten (10) audited accounts, the amount refunded was less than $200 and represented either fiscal year end interest that was credited to the accounts after the initial refund or the refund amount represented contributions that were "trailing" due to late reporting from the member's employer. The 20% federal tax withholding did not occur for these distributions for the following reason:

> *A business rule exists in START that requires the distribution to be $200 or greater before the mandatory 20% federal tax withholding occurs.*

The above-referenced business rule also existed in KRS' legacy system as a result of staff's understanding from KRS' federal tax counsel. The application of this business rule has been referred for review again by KRS' federal tax counsel. If counsel advises KRS to aggregate all distributions within a single tax year, KRS can remove the business rule so that all taxable distributions, without regard to amount, will be subject to 20% withholding unless member elects to rollover the funds into a qualified plan.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-18: The Compliance Officer Did Not Complete Monthly Reviews Of Investment Transactions Timely

During the FY 13 audit of KRS, we reviewed work performed by the KRS compliance officer. A new compliance officer started in April 2013, approximately six months after the prior compliance officer was assigned to different job tasks and subsequently a new position. Each month, the compliance officer tests samples of transactions of each investment category. The officer recalculates the interest income, principal pay down, purchase or sale amounts, and agrees the recalculated amounts to the investment manager's records and/or the custodian bank's records. These monthly reviews ensure recalculated investment income is accurate and purchases and sales are verified. KRS' Investment section relies on the spot checks performed by the compliance officer as a tool for monitoring proper recording and tracking of purchases, sales, income, and pay downs.

As of June 30, 2013, the fixed income reviews were not completed from January 2013 to June 2013 and the equities and alternative investment reviews were not completed from April 2013 to June 2013.

Due to the delay in hiring a compliance officer, there is a backlog of monthly reviews. KRS has a monitoring tool for investments in place; however there was no monitoring of transactions by a compliance officer for half of FY 13. Errors could have occurred and not been detected timely.

Per the Division of Internal Audit Procedure manual, the compliance officer, "Audits the activities and various functions of investment operations, as directed by the audit plan and requested by management, to insure proper internal controls and compliance with internal policies and procedures."

Recommendation

We recommend KRS ensure the compliance officer job tasks be completed timely in the future. In addition, KRS may consider assigning a back up person to perform the compliance officer duties.

Management's Response and Corrective Action Plan

KRS agrees with this finding.

KRS agrees that monthly reviews should have been conducted in a more timely manner. However, reviews for June 2013 could not have been completed on June 30, 2013 since information from the investment managers and the custodial bank is typically available beginning fifteen business days after the month end.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-18: The Compliance Officer Did Not Complete Monthly Reviews Of Investment Transactions Timely (Continued)

Management's Response and Corrective Action Plan (Continued)

The backlog of reviews was a result of the transition of the previous Compliance Officer to the Deputy Controller's position. Reviews of income, principal paydowns (fixed income only) along with purchase and sell transactions, for both equity and fixed income asset classes, for the entire 2013 fiscal year have been completed. Capital call and manager distributions received for the alternative asset class has also been reconciled for the entire 2013 fiscal year.

Going forward the Compliance Officer will complete reviews in a more timely manner. Additionally, procedures are being drafted so that Internal Audit personnel may serve as a back-up in performing the Compliance Officer's duties.

2013-KRS-19: KRS Incorrectly Paid An Invoice From The Custodian Bank

Kentucky Retirement Systems (KRS) contracts with a custodian bank to maintain custody of assets and perform various administrative and bookkeeping services related to investments. During our review of KRS contract with the custodian bank, we noted the contract extension for FY 13 changed the payment arrangement from a fixed fee to a fee for specific services. We reviewed the contract and invoices and noted:

- The invoice submitted to KRS from the custodian bank for the period ending September 30, 2012 was based on the FY 12 fixed fee amount of $62,500 per quarter. The use of the incorrect fee calculation method was not caught by the custodian bank when the bill was sent or by KRS when the bill was reviewed and approved for payment.
- The approval and payment dates for this invoice were in April 2013. There is no date on the invoices from the custodian bank documenting when the bill was sent to KRS and the due date is "upon receipt." There is no date received stamp from KRS or email documenting the date the invoice was sent to and received by KRS.
- KRS did not receive any additional bills from the custodian until June 2013 when the auditor asked to review the custodian invoices for the year. The subsequent bills indicate KRS overpaid by $20,156 per the custodian's calculations for the period ending September 30, 2012. The custodian showed a credit for this amount on the additional bills received by KRS in June 2013.

KRS personnel were accustomed to the fixed fee amount and did not realize the quarterly invoice amount would no longer be a fixed amount until the auditor's inquiry. We have no way of determining if the bill from the custodian was paid timely because there is no date received on the invoice. KRS overpaid the custodian bank by $20,156.

Good internal controls dictate the agency document when invoices are received and review invoices for accuracy of the calculations and amount prior to payment.

Recommendation

We recommend KRS:

- Date stamp the invoices when they are received or if received electronically, include the email with the invoice.
- Verify the custodian bank's calculation of the amount owed is correct during the review process.

Management's Response and Corrective Action Plan

KRS agrees with the finding.

KENTUCKY RETIREMENT SYSTEMS
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2013
(Continued)

2013-KRS-19: KRS Incorrectly Paid An Invoice From The Custodian Bank (Continued)

Management's Response and Corrective Action Plan (Continued)

KRS will date stamp or otherwise document the receipt date of invoices and procedures will be developed to verify the custodian calculation is consistent with the current contract.

KRS will notify all who receive invoices to provide documentation of the receipt date with the invoice.