



FINANCIAL AND COMPLIANCE AUDIT REPORT

**Kansas Public Employees Retirement System
Fiscal Year 2003**

**A Report to the Legislative Post Audit Committee
By Berberich Trahan & Co., a certified public accounting firm
under contract with the Legislative Division of Post Audit
State of Kansas
December 2003**

Legislative Post Audit Committee

Legislative Division of Post Audit

The Legislative Post Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$8 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of government agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U. S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. These audit standards have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the representatives, three are appointed by the Speaker of the House and two are appointed by the House Minority Leader.

As part of its audit responsibilities, the Division is charged with meeting the requirements of the Legislative Post Audit Act which address audits of financial matters. Those requirements call for two major types of audit work.

First, the Act requires an annual audit of the State's financial statements. Those statements, prepared by the Department of Administration's Division of Accounts and Reports, are audited by a certified public accounting firm under contract with the Legislative Division of Post Audit. The firm is selected by the Contract Audit Committee, which comprises three members of the Legislative Post Audit Committee (including the Chairman and Vice-Chairman), the

Secretary of Administration, and the Legislative Post Auditor. This audit work also meets the State's audit responsibilities under the federal Single Audit Act.

Second, the Act provides for a regular audit presence in every State agency by requiring that audit work be conducted at each agency at least once every three years. Audit work done in addition to the annual financial statement audit focuses on compliance with legal and procedural requirements and on the adequacy of the audited agency's internal control procedures. These compliance and control audits are conducted by the Division's staff under the direction of the Legislative Post Audit Committee.

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Representative Tom Burroughs
Representative Bill McCreary
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Representative Dan Thimesch

Senator Derek Schmidt, Vice-Chair
Senator Bill Bunten
Senator Anthony Hensley
Senator Dave Kerr
Senator Chris Steineger

LEGISLATIVE DIVISION OF POST AUDIT

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Barbara J. Hinton, Legislative Post Auditor

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December 12, 2003

To: Members, Legislative Post Audit Committee

Representative John Edmonds, Chair	Senator Derek Schmidt, Vice-Chair
Representative Tom Burroughs	Senator Bill Bunten
Representative Bill McCreary	Senator Anthony Hensley
Representative Frank Miller	Senator Dave Kerr
Representative Dan Thimesch	Senator Chris Steineger

This report contains significant findings, conclusions, and recommendations from the completed financial-compliance audit of the Kansas Public Employees Retirement System covering fiscal year 2003. This audit was conducted by Berberich Trahan & Co., a certified public accounting firm under contract with the Legislative Division of Post Audit.

The report emphasizes certain information relating to employer contribution rates and the System's unfunded actuarial liability. We would be happy to discuss this report with any legislative committees, individual legislators, or other State officials.

A stylized, handwritten signature in black ink that reads "Barbara J. Hinton".

Barbara J. Hinton
Legislative Post Auditor

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

FINANCIAL AND COMPLIANCE AUDIT REPORT

Year Ended June 30, 2003

TABLE OF CONTENTS

	<u>Page</u>
Introduction	1
Audit Findings and Recommendations	2
Status of Prior Year Findings and Recommendations	3
Independent Auditors' Report	4
Management's Discussion and Analysis	5 - 10
Basic Financial Statements:	
Statement of Plan Net Assets	11
Statement of Changes in Plan Net Assets	12
Notes to Basic Financial Statements	13 - 30
Required Supplementary Information:	
Schedule of Employer Contributions	31
Schedule of Funding Progress	32
Actuarial Valuation	33
Supplementary Information:	
Schedule of Contributions	34
Schedule of Administrative Expenses	35
Schedule of Investment Income by Asset Class	36
Schedule of Investment Fees and Expenses	37
Investment Summary	38
Expenses by Type	39
Cash Receipts and Disbursements	39
Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	40

INTRODUCTION

The Kansas Public Employees Retirement System (the System or KPERS) provides a systematic retirement plan, as well as group life and disability insurance coverage for Kansas public employees who are Plan members. Plan membership generally requires that a person be employed by a participating employer for more than one year. The System is actually an umbrella organization administering the following three statewide retirement systems under one plan, as provided by K.S.A. 74, Article 49: the Kansas Public Employees Retirement System, the Kansas Police and Firemen's Retirement System, and the Kansas Retirement System for Judges.

In order to pay the various retirement, disability and death benefits to eligible System members and beneficiaries, the System accumulates assets by receiving employer and employee contributions, and by receiving earnings on its investments. The System maintains six reserves used to accumulate contributions and earnings, and to pay benefits. Investment decisions are made by contracted investment management firms and are monitored by the System's investment staff. Employer contribution rates are recommended by the System's actuary. Employee contribution and benefit formulas are legislated by State statute.

The audit work performed fulfills the annual audit requirements mandated by the Public Employees Retirement Act.

AUDIT FINDINGS AND RECOMMENDATIONS

Emphasis of Certain Matters Contained in the Financial Statements

We would like to emphasize two matters which involve actuarial evaluations since our report does not contain the actuary's report which is included in KPERS' annual report. Both are contained on pages 31 and 32 of this report.

Employers' Contributions - As can be seen on the chart on page 31, the percentage contributed in 2003 versus the annual actuarial recommended contribution was 78.9%. The basic reason for the current difference is that legislation has limited the amounts that employers are required to contribute for State/School employees and Local employees. The actuarial impact on the unfunded actuarial liability was \$ 143 million for the year ended June 30, 2003.

Unfunded Actuarial Accrued Liability - In the schedule of funding progress on page 32, the unfunded actuarial accrued liability at December 31, 2002 is reflected at \$2.83 billion which is up from \$ 1.78 billion at December 31, 2001. On page 27 there is a table showing the changes in the unfunded actuarial liability for the year ended December 31, 2002.

The funding objective of the system is to establish contribution rates that over time will remain relatively level, as a percentage of payroll, and to pay off the unfunded liability by the year 2033. It should be noted that the actuarial report has the following sentences: "The valuation shows that the current assets plus the present value of future contributions are not equal to the present value of future benefits and thus the System is not in "actuarial balance." Due to negative investment experience and the delayed reflection of market experience in the actuarial value of assets, it is expected that additional actuarial losses will be reflected in the unfunded actuarial liability over the next few years, which will exacerbate the long-term funding concerns, while the 2003 Legislature increased future contribution rates by ultimately raising the statutory cap to .6%, the statutory and actuarial rates are still not projected to converge." We encourage the reading of the actuarial section of KPERS' Annual Report as it gives a look at the System over the long term while the financial statements in this report give a "snapshot" picture of the System's financial position at June 30, 2003.

STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS

Emphasis of Certain Matters Contained in the Financial Statements

See current year findings and recommendations.



Berberich Trahan & Co., P.A.

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INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Kansas Public Employees Retirement System:

We have audited the accompanying statement of plan net assets of the Kansas Public Employees Retirement System (System) as of June **30, 2003**, and the related statement of changes in plan net assets for the year then ended. These basic financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these basic 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 financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. **An** audit also includes assessing the accounting principles used and significant estimates made by management, **as** well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the plan net assets of the Kansas Public Employees Retirement System as of June **30, 2003**, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September **9, 2003** on our consideration of the System's internal control over financial reporting and our tests on its compliance with certain provisions of laws, regulations and contracts. That report is an integral part **of** an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on pages 5 through 10 and the Required Supplementary Information on pages **31** through **33** are not a required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The supplemental information included on pages **34** through **39** is presented for purposes of additional analysis and is not a required part **of** the basic financial statements. This supplemental information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Berberich Trahan & Co., P.A.

September **9, 2003**



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Management's Discussion & Analysis

This section presents management's discussion and analysis of the Kansas Public Employees Retirement System (KPERs) financial performance during the fiscal year ended June 30, 2003.

The Kansas Public Employees Retirement System (the Retirement System, or the System) is an umbrella organization administering the following three statewide pension groups under one plan, as provided by chapter 74, article 49 of the Kansas Statutes:

- Kansas Public Employees Retirement System
- Kansas Police and Firemen's Retirement System
- Kansas Retirement System for Judges

All three systems are part of a governmental, defined benefit, contributory plan covering substantially all public employees in Kansas. The Kansas Retirement System for Judges is a single employer group, while the other two are multi-employer, cost-sharing groups. Participation by the State of Kansas and Kansas school districts is mandatory, whereas participation by local political subdivisions is optional but irrevocable once elected.

Financial Highlights

- The System's net assets increased by \$28.2 million or .3 percent from \$ 8,902,288,000 to \$ 8,930,442,322.
- As of December 31, 2002, the date of the most recent actuarial valuation, the Retirement System's funded ratio was 77.6%.
- The unfunded actuarial liability increased from \$ 1.780 billion at December 31, 2001, to \$2.829 billion at December 31, 2002.
- On a market value basis, this year's investment return rate was positive 4.0 percent, compared with last year's negative return. The increase was primarily due to the growth in TIPS and other fixed income securities markets and a positive fourth quarter of the fiscal year in the equity markets.
- Monthly benefits paid to retirees and beneficiaries increased 3 percent from \$627 million in fiscal year 2002 to \$646 million in fiscal year 2003.

Overview of the Financial Statements

This discussion and analysis is an introduction to the System's basic financial statements, which comprise the following components:

- 1) Basic financial statements
- 2) Notes to basic financial statements
- 3) Required supplementary information
- 4) Supplementary information.

The information available in each of these sections is briefly summarized as follows:

(1) Basic Financial Statements

A Statement of Plan Net Assets as of June 30, 2003 and a Statement of Changes in Plan Net Assets for the fiscal year ended June 30, 2003 are presented with previous year's comparative information. These financial statements reflect the resources available to pay benefits to retirees and other beneficiaries as of year-end, as well as the changes in those resources during the year.

(2) Notes to Basic Financial Statements

The financial statement notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. Information available in the notes to the basic financial statements is described below.

- Note 1 provides a general description of the Retirement System, as well as a description of the plan benefits and an overview of the contributions that are paid by employers and members. Information regarding a breakdown of the number of participating employers and members is also provided.
- Note 2 provides a summary of significant accounting policies, including the basis of accounting, investments, including investing authority, investment **risk** categorizations, and the method used to value investments, and additional information about cash, securities lending, and derivatives. In the Reserves section of Note 2 is information regarding the Retirement System's required reserves. The various reserves include the Members Accumulated Contribution Reserve, Retirement Benefit Accumulation Reserve, Retirement Benefit Payment Reserve, Group Insurance Reserve, the Expense Reserve, and the Retirant Dividend Payment Reserve.
- Note 3 provides information about System funding policies and employer contributions made to the System by the three different funding groups.
- Note 4 describes the System capital expenditure commitments to real estate and alternative investments. This section also generally describes the potential System contingencies.

(3) Required Supplementary Information

The required supplementary information consists of two schedules and related notes concerning the funded status of the pension plans administered by the Retirement System.

(4) Supplementary Information

Supplementary schedules include detailed information on contributions by employer coverage groups, administrative expenses, an investment income summary, a schedule of investment fees and expenses, an investment summary, a schedule of expenses by type, and a schedule of cash receipts and disbursements.

Financial Analysis of the Retirement System

The System provides benefits to State of Kansas and other Kansas local and school employees. Benefits are funded by member and employer contributions and by investment earnings. Net assets held in trust for benefits at June 30, 2003 amounted to \$ 8,930,442,322, an increase of \$28.2 million (0.30 percent) from \$ 8,902,288,000 at June 30, 2002. Following are two summary schedules, Plan Net Assets and Changes in Plan Net Assets, comparing information from fiscal years 2003 and 2002.

Summary Comparative Statements of Plan Net Assets

	As of June 30, 2003	As of June 30, 2002	Percentage Change
Assets			
Cash and deposits	\$ 5,261,095	\$ 6,715,665	(21.66) %
Receivables	1,538,278,206	1,485,832,660	3.53
Investments at fair value	9,388,170,382	9,300,425,561	0.94
Invested securities lending collateral	1,860,279,374	1,544,443,171	20.45
Capital assets and supplies inventory	242,170,171	2,804,738	(13.66)
Total assets	12,794,410,758	12,340,221,795	3.68
Liabilities			
Administrative costs	904,441	649,094	39.34
Benefits payable	1,325,501	2,423,781	(45.31)
Securities purchased	2,001,459,120	1,890,417,749	5.87
Securities lending collateral	1,860,279,374	1,544,443,171	20.45
Total liabilities	3,863,968,436	3,437,933,795	12.39
Net assets	\$ 8,930,442,322	\$ 8,902,288,000	0.32 %

Summary Comparative Statements of Changes in Plan Net Assets

	Year Ended June 30, 2003	Year Ended June 30, 2002	Percentage Change
Additions			
Contributions	\$ 456,210,770	\$ 431,097,742	5.83 %
Net investment income (loss)	322,252,818	(467,057,944)	169.00
Net income from securities lending activities	3,803,825	33,109,985	14.88
Total net investment income (loss)	326,056,643	(463,746,959)	170.31
Other miscellaneous income	82,257	137,633	(40.23)
Total additions (net reductions)	782,349,670	(32,511,584)	2,506.37
Deductions			
Monthly retirement benefits	645,716,079	627,704,056	2.87
Refunds of contributions	39,608,946	39,066,937	1.39
Death benefits	7,826,064	8,694,809	(9.99)
Insurance premiums and benefits	53,829,235	47,625,764	13.03
Administrative expenses	7,215,024	6,776,044	6.48
Total deductions	754,195,348	729,867,610	3.33
Net increase (decrease)	28,154,322	(762,379,194)	103.69
Net assets, beginning of year	8,902,288,000	9,664,667,194	(7.89)
Net assets, end of year	\$ 8,930,442,322	\$ 8,902,288,000	0.32 %

Additions to the System's net assets held in trust for benefits include employer and member contributions, as well as investment income. Total contributions to the System increased from \$431.1 million in fiscal year 2002 to \$456.2 million in fiscal year 2003. The \$25.1 million increase in contributions is attributed to increased active member salary base and higher employer contribution rates for state, school and local members (with the rate from the previous year limited to a statutory cap).

Following two consecutive years of negative investment performance the System achieved a positive return for fiscal year 2003. The System recognized a net investment gain of \$326 million for the 2003 fiscal year, compared with a net investment loss of \$463 million for the 2002 fiscal year. Total return for the portfolio was positive 4.0 percent. System net investments amounted to \$ 8.89 billion at June 30, 2003, which was \$29.4 million (0.33 percent) more than the \$ 8.86 billion in total System investments at June 30, 2002. The Retirement System's one, three, five, and ten year investment performance against the assumed rate of investment return are shown in the chart below.

<u>One Year</u>	<u>Latest 3 Years</u>	<u>Latest 5 Years</u>	<u>Latest 10 Years</u>	<u>Assumed Rate of Return</u>
4.03%	(2.80)%	3.05%	8.31%	8.00%

At June 30, 2003, the System held \$4.6 billion in U.S. equity and international equity securities, an increase of \$364 million from the 2002 fiscal year. U.S. equity and international equity securities earned returns of approximately positive 0.9 percent and negative 7.6 percent, respectively, for the 2003 fiscal year. These compare with the Retirement System's benchmark returns of positive 0.80 percent and negative 8.2 percent, respectively.

The System held \$ 3.3 billion in U.S. debt and international debt securities, a decrease of \$241 million from the 2002 fiscal year. The TIPS portfolio return for 2003 was positive with a return of 19.4 percent versus the benchmark return of 19.4 percent. The performance of the System's other fixed income securities during fiscal year 2003 was 14.0 percent compared with the benchmark of 13.6 percent. Real estate investments decreased \$ 66 million to \$623.6 million at June 30, 2003. Real estate investments returned approximately 6.4 percent for the 2003 fiscal year, versus the benchmark real estate return of 4.8 percent. The System held \$483.14 million in alternative investments, which was nearly unchanged from June 30, 2002 of \$483.15 million. Alternative investments earned a negative return of approximately 14.2 percent for the 2003 fiscal year, compared to the benchmark alternative investment return of a positive 5.6 percent. At June 30, 2003, the System held \$379.8 million in short-term investments, which was an increase of \$29.9 million from June 30, 2002.

The System earns additional investment income by lending investment securities to brokers. The brokers provide collateral to the System and generally use the borrowed securities to cover short sales and failed trades. The Retirement System invests cash collateral received from the brokers in order to earn interest. For the fiscal year 2003, net securities lending income amounted to \$ 3.8 million compared with \$ 3.3 million in fiscal year 2002.

Deductions from net assets held in trust for benefits include retirement, death, and survivor benefits, and administrative expenses. For the 2003 fiscal year, retirement, death, and insurance benefits amounted to \$ 746.9 million, an increase of \$23.8 million (3 percent) from the 2002 fiscal year. The increase in benefit payments was a result of an increase in the number of retirees. For the 2003 fiscal year, System administrative expenses amounted to \$ 7.215 million compared with \$ 6.776 million in fiscal year 2002.

The ratio of System administrative expenses to the number of members (approximately \$29 per member) continues to be very cost efficient for a statewide retirement plan.

Funding Status

An actuarial valuation of the Retirement System's assets and benefit obligations is performed annually. At the date of the most recent actuarial valuation, December 31, 2002, the funded status decreased to 77.6 percent from 84.8 percent at December 31, 2001. The unfunded actuarial liability was \$2.829 billion at December 31, 2002, compared with \$ 1.780 billion at December 31, 2001. This decrease in funded status relates primarily to three consecutive years of investment returns that are below the assumed rate of return of 8 percent.

The System's consulting actuary has recommended that future employer contributions be increased to improve the long-term funding of the KPERS State/School and Local groups. During the 2003 legislative session, legislation was passed that increased the statutory cap on employer contributions of the State/School group to 0.40 percent in fiscal year 2006, with subsequent increases of 0.50 percent in fiscal year 2007 and 0.60 percent in fiscal year 2008 and beyond. In addition, up to \$ 500 million in pension obligation bonds were authorized to be issued for the purpose of reducing a portion of the unfunded actuarial liability for the State/School group. The issuance of the bonds is contingent upon an extensive review and approval process outlined in the law. Absent any other changes in future contribution levels and using assumptions adopted by the Board of Trustees, the System's actuary projects the unfunded liability for the State/School group will exceed \$ 6 billion with a resulting estimated funded ratio of around 55 percent by 2013. In addition to the overall financial deterioration, the System's cash flow needs and investment strategy would need to change to provide the liquidity needed to pay benefits. It is important to note that this is a long-term funding problem rather than an immediate crisis. The Retirement System will continue to make all benefit payments to members, and benefit payments are not in jeopardy.

During the past two years, it has been KPERS objective to develop a consensus among the Legislature, Governor, and other interested parties on a comprehensive funding plan to ensure the System's financial health. The passage of the 2003 legislation providing increases in employer contribution rates and the potential issuance of pension obligation bonds was a significant initial step in this plan. During the 2003 interim, the Legislature's Joint Committee on Pensions, Investments, and Benefits is charged with developing a comprehensive long-term funding plan for the System. KPERS is working closely with the Joint Committee to analyze a range of funding alternatives and finalize the plan for consideration by the Governor and Legislature in 2004.

Death & Disability Program

In addition, KPERS administers the group insurance reserve fund as described in Note 2 of the notes to the basic financial statements. The actuary performs an annual actuarial valuation of this fund, with the last valuation completed for June 30, 2002. At that time, the fund was 77.5 percent funded with assets of \$ 121.9 million.

A moratorium on contributions was in place for the first 6 months of fiscal year 2003 and legislation passed by the 2003 Legislature placed another moratorium effective April 1, 2003. The three-quarter moratorium in fiscal year 2003 was the primary reason assets decreased to \$72.3 million at June 30, 2003. The 2003 legislation also extended the moratorium on contributions to this fund for all of fiscal year 2004. The projected funded ratio of this reserve will drop to less ~~than~~ 25 percent by the end of fiscal year 2004.

Preliminary budget plans are to resume the historical contributions (0.6 percent of payroll) to this fund beginning in fiscal year 2005. This level of funding will not be sufficient to return the program to full funding and it is projected that the program will be on a pay-as-you-go basis in fiscal year 2006. As with the long-term retirement funding plan, the KPERS Board of Trustees is committed to work with the Legislature and Governor's Office to develop a funding plan for the death and disability program to ensure adequate resources are available to pay death and disability benefits.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

STATEMENT OF PLAN NET ASSETS

June 30, 2003
With Comparative Totals for June 30, 2002

	2003	2002
<u>ASSETS</u>		
Cash and deposits (Note 2):		
Cash	\$ 47,507	\$ 147,584
Deposits with insurance carrier	5,213,588	6,568,081
Total cash and deposits	5,261,095	6,715,665
Receivables:		
Contributions	35,120,391	35,412,055
Investment income	40,963,683	47,479,206
Sale of investment securities	1,462,194,132	1,402,941,399
Total receivables	1,538,278,206	1,485,832,660
Investments at fair value (Note 2):		
Domestic equities	3,024,580,762	2,832,120,160
International equities	1,621,533,252	1,449,504,908
Cash and equivalents	379,764,010	349,882,452
Fixed income	3,255,500,484	3,496,030,986
Alternative investments	483,143,921	483,148,414
Real estate	623,647,953	689,738,641
Total investments at fair value	9,388,170,382	9,300,425,561
Invested securities lending collateral (Note 2)	1,860,279,374	1,544,443,171
Capital assets and supplies inventory	2,421,701	2,804,738
Total assets	12,794,410,758	12,340,221,795
<u>LIABILITIES</u>		
Administrative costs	904,441	649,094
Benefits payable	1,325,501	2,423,781
Securities purchased	2,001,459,120	1,890,417,749
Securities lending collateral	1,860,279,374	1,544,443,171
Total liabilities	3,863,968,436	3,437,933,795
Net assets held in trust for pension benefits (a schedule of funding progress for the plan is presented on page 32)	\$ 8,930,442,322	\$ 8,902,288,000

See accompanying notes to basic financial statements.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
STATEMENT OF CHANGES IN PLAN NET ASSETS

Fiscal Year Ended June 30, 2003
With Comparative Totals for Fiscal Year Ended June 30, 2002

	2003	2002
Additions:		
Contributions:		
Member contributions	\$ 224,746,447	\$ 209,624,015
Employer contributions	23 1,464,323	221,473,727
Total contributions	456,210,770	43 1,097,742
Investments:		
Net appreciation (depreciation) in fair value of investments	85,233,479	(676,384,745)
Interest	145,411,285	159,209,184
Dividends	76,508,361	24,416,401
Real estate income, net of operating expenses	31,217,255	44,792,323
Other investment income	557,611	667,029
	338,927,991	(447,299,808)
Less investment expense	(16,675,173)	(19,758,136)
Net investment income (loss)	322,252,818	(467,057,944)
From securities lending activities:		
Securities lending income	25,878,944	33,310,814
Securities lending expenses:		
Borrower rebates	(20,861,098)	(28,577,302)
Management fees	(1,214,021)	(1,422,527)
Total securities lending activities expenses	(22,075,119)	(29,999,829)
Net income from securities lending activities	3,803,825	3,310,985
Total net investment income (loss)	326,056,643	(463,746,959)
Other miscellaneous income	82,257	137,633
Total additions (net reductions)	782,349,670	(32,511,584)
Deductions:		
Monthly retirement benefits paid	(645,716,079)	(627,704,056)
Refunds of contributions	(39,608,946)	(39,066,937)
Death benefits	(7,826,064)	(8,694,809)
Insurance premiums and benefits	(53,829,235)	(47,625,764)
Administrative expenses	(7,215,024)	(6,776,044)
Total deductions	(754,195,348)	(729,867,610)
Net increase (decrease)	28,154,322	(762,379,194)
Net assets held in trust for pension benefits:		
Balance, beginning of year	8,902,288,000	9,664,667,194
Balance, end of year	\$ 8,930,442,322	\$ 8,902,288,000

See accompanying notes to basic financial statements.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL, STATEMENTS

June 30,2003

1 - Plan Description

Plan Membership

The Kansas Public Employees Retirement System (the Retirement System or, the System) is a body corporate and an instrumentality of the State of Kansas. The Retirement System is an umbrella organization administering the following three statewide pension groups under one plan, as provided by K.S.A. 74, Article 49: the Kansas Public Employees Retirement System (KPERS), the Kansas Police and Firemen's Retirement System (KP&F), and the Kansas Retirement System for Judges (Judges). All three systems are part of a tax-exempt, defined benefit, contributory plan covering substantially all public employees in Kansas. The Kansas Retirement System for Judges is a single employer group, while the other two are multi-employer, cost sharing groups. Participation by the State of Kansas is mandatory, whereas participation by local political subdivisions is optional but irrevocable once elected. Participating employers and Retirement System membership are as follows:

Number of participating employers:

	KPERS	KP&F	Judges
State of Kansas	1	1	1
Counties	105	22	-
Cities	356	47	-
Townships	53	-	-
School Districts	305	-	-
Libraries	116	-	-
Conservation Districts	82	-	-
Extension Councils	79	-	-
Community Colleges	44	-	-
Recreation Commissions	37	-	-
Hospitals	29	-	-
Cemetery Districts	14	-	-
Other	150	-	-
Total	<u>1,371</u>	<u>70</u>	<u>1</u>

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

1 - Plan Description (Continued)

Plan Membership (Continued)

Membership by retirement systems:

	<u>KPERS</u>	<u>KP&F</u>	<u>Judges</u>	<u>Total</u>
Retirees and beneficiaries currently receiving benefits	54,105	3,338	154	57,597
Terminated employees entitled to benefits but not yet receiving them	7,914	109	12	8,035
Inactive members not entitled to benefits	31,514	852	3	32,369
Current employees	<u>140,498</u>	<u>6,548</u>	<u>248</u>	<u>147,294</u>
Total	<u>234,031</u>	<u>10,847</u>	<u>417</u>	<u>245,295</u>

KPERS members' benefits vest with 10 years of credited service. KP&F members' benefits vest with 20 years of credited service for Tier I, and with 15 years of credited service for Tier II. Normally, 10 years of credited service is required for members of the Retirement System for Judges to become vested.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

1 - Plan Description (Continued)

Plan Benefits

Members (except KP&F members) with 10 or more years of credited service may retire as early as age 55 (KP&F members may be age 50 with 20 years of credited service) with an actuarially reduced monthly benefit. Normal retirement is at age 65, age 62 with 10 years of credited service, or whenever a member's combined age and years of credited service equal 85 "points" (KP&F members' normal retirement ages are age 60 with 15 years of credited service, age 55 with 20 years, or age 50 with 25 years). Monthly retirement benefits are based on a statutory formula that includes final average salary and years of service. Upon termination of employment, members may elect to withdraw the accumulated contributions from their individual accounts, including the interest that has been credited to the account. Members who withdraw their accumulated contributions forfeit all rights and privileges accrued during membership. Members choose one of seven options to receive their monthly retirement benefits. At retirement a member may receive a lump-sum payment of up to 50 percent of the actuarial present value of the member's lifetime benefit. His or her monthly retirement benefit is then permanently reduced. Benefit increases, including ad hoc post-retirement benefit increases, must be approved and passed into law by the Kansas Legislature. Benefit increases are under the authority of the Legislature and the Governor of the State of Kansas.

All active members (except KP&F members) are covered by the group life insurance contract. The life insurance benefit is 150 percent of the annual rate of compensation at the time of an active member's death. Generally, in cases of death as a result of an on-the-job accident, for KPERS members there is a \$50,000 lump sum benefit and a monthly benefit payable to a surviving spouse, minor children, or dependent parents (in this order of preference). Service-connected accidental death benefits are in addition to any life insurance benefit. There is a \$4,000 death benefit payable to the beneficiary(ies) upon the death of a retired member under any of the three systems.

Active members (except KP&F and Judges members) are also covered by the provisions of the disability income benefit contract. Annual disability income benefits are based upon two-thirds of the annual rate of compensation at the time of disability, less primary social security benefits, one-half of worker's compensation, and any other employment-related disability benefit, with a minimum monthly benefit of \$ 100. There is a waiting period of 180 continuous days from the date of disability before benefits can be paid. During the period of approved disability, the member continues to have group life insurance coverage and to accrue participating service credit.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

1 - Plan Description (Continued)

Contributions

Member contributions (from four percent to seven percent of gross compensation), employer contributions and net investment income fund the reserves of the Retirement System. Member contribution rates are established by state law and are paid by the employer according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rates be determined based on the results of each annual actuarial valuation. All of the retirement systems are funded on an actuarial reserve basis (see Note 3). For fiscal years beginning in 1995, State of Kansas legislation placed statutory limitations on annual increases in the contribution rates for KPERS employers of 0.1% of payroll over the prior year. During the 1995 legislative session, the statutory limits were increased to 0.2% of payroll over the prior year for fiscal years beginning in 1996 for state and school employers. The statutory increase for local units of government was amended to increases no more than 0.15% over the prior year for calendar years beginning in 1997. Annual increases in the employer contribution rates related to subsequent benefit enhancements are not subject to these limitations. Legislation passed in 2003 amended the annual increases in future years. The statutory cap for the State/School group will increase to 0.4% in fiscal year 2006, with subsequent increases of 0.5% in fiscal year 2007 and 0.6% in fiscal year 2008 and beyond. The amortization period for the unfunded liability of all three systems is 40 years from July 1, 1993.

Employer contributions for group life insurance and long-term disability income benefits are set by statute at 0.6% of covered payroll for KPERS and 0.4% for Judges. However, legislation passed in 2000 and 2001 placed a moratorium on contributions related to the group life insurance and disability benefits effective for the periods April 1, 2000 through December 31, 2001. Calendar year 2002 and 2003 legislation placed additional moratoriums on contributions to this fund. Moratoriums were in effect for the period July 1, 2002 through December 31, 2002 and the period of April 1, 2003 through June 30, 2003. In addition, 2003 legislation extends the moratorium through June 30, 2004, making an overall total of 14 quarters of moratorium on contributions.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies

Reporting Entity

The Kansas Public Employees Retirement System is a component unit of the State of Kansas. A nine-member board of trustees administers the Retirement System: four trustees are appointed by the governor, one by the president of the Senate, one by the speaker of the House of Representatives, two are elected by Retirement System members, and one is the state treasurer. The Board of Trustees appoints the executive director, who is the Retirement System's managing officer.

Basis of Accounting

The financial statements of the Retirement System are prepared on the accrual basis in accordance with accounting principles generally accepted in the United States of America. Plan member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Method Used to Value Investments

Investments are reported at fair value. Securities traded on a national or international securities exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate investments is based on independent appraisals. Investments that are not publicly traded are reported at estimated fair value.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies (Continued)

Cash and Deposits

Cash deposits are classified in three categories of credit risk to give an indication of the level of risk assumed by the Retirement System. The three categories of credit risk are:

1. Insured or collateralized with securities held by the State Treasurer or its custodian in the name of the State of Kansas,
2. Collateralized with securities held by the pledging financial institution's trust department or custodian in the name of the State of Kansas, and
3. Uncollateralized.

As of June 30, 2003, cash deposits of \$47,507 held by the State Treasurer were in credit risk category "1". The Retirement System's deposits with its insurance carrier were \$ 5,213,588 at June 30, 2003, and were in credit risk category "3".

Investments

Investments and the investment process are governed by K.S.A. 74-4921. The Board of Trustees maintains a formal Statement of Investment Policy, which addresses the governing provisions of the law, as well as specifying additional guidelines for the investment process.

Statutory authority for the investment program of the Kansas Public Employees Retirement System is provided for in K.S.A. 74-4901, et. seq., effective July 1, 1993. The Retirement Act addresses the following areas:

- Establishes the structure of the Board of Trustees, defines the Trustees' responsibilities and imposes the prudent expert standard upon the Trustees' actions with respect to managing the assets of the Retirement System.
- Requires that the assets be invested to preserve capital and solely to provide benefits to members and the members' beneficiaries.
- Limits the possible allocation of common stock to 60 percent of the total book value of the fund.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies (Continued)

Investments (Continued)

- Limits the allocation of private placements and other alternative (non-publicly traded) investments to five percent (5%) of the total investment assets of the fund, but if market forces increase allocations above the 5% limitation, it does not require the sale of such investments held unless the sale is in the best interests of members.
- Establishes limits on the structure of future investments in real estate or alternative investments.
- Requires that the Board develop investment policies and objectives for the investment and reinvestment of the assets of the fund.
- Authorizes the Board to hire qualified professionals/firms to assist in the investing of the fund and to require that such professionals/firms obtain errors and omissions insurance coverage and fidelity bond insurance coverage.
- Authorizes the Board to pay for the services of retained professionals/firms at the rates fixed by the Board, excluding any reimbursement for expenses and subject to the provisions of the appropriations acts.
- Provides for an annual audit and requires that the Board annually examine the investment program, specific investments and its policies and practices.

At June 30, 2003, the Retirement System did not have investments (other than those issued by the U.S. government) in any one organization representing 5% or more of the System's assets.

The Retirement System's permissible investment categories include equities, fixed income securities, cash equivalents, real estate, derivative products, and alternative investments. In fulfilling its responsibilities, the Board of Trustees has contracted with 14 investment management firms and a master global custodian.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies (Continued)

Investments (Continued)

Presently the Retirement System has investments in the financial futures market. Futures contracts are contracts for delayed delivery or receipt of securities in which the seller agrees to make delivery and the buyer agrees to take delivery at a specified future date, of a specified instrument, at a specified price. Market risk arises due to market price and interest rate fluctuations that may result in a decrease in the market value of futures contracts. Futures contracts are traded on organized exchanges and require initial margin in the form of cash or marketable securities. Daily, the net change in the futures contract value is settled in cash with the exchanges. Holders of futures contracts look to the exchange for performance under the contract. Accordingly, the credit risk due to nonperformance of counterparties to futures contracts is minimal. At June 30, 2003, the Retirement System had futures contracts with a fair value of approximately \$ 124,000,000. Cash equivalents and short-term investments in amounts necessary to settle the futures contracts were held in the portfolio so that no leverage was employed, in accordance with Statement of Investment Policy.

The Retirement System's Statement of Investment Policy authorizes participation in a securities lending program administered by its master global custodian, Mellon Trust. The System receives income from the loan of the securities, in addition to the income which accrues to the System as owner of the securities. The securities loans are open contracts and therefore could be terminated at any time by either party. The type of securities lent include U.S. Government securities, domestic and international equities, and domestic and international bonds. The borrower collateralizes the loan with either cash or government securities of 102 percent of fair value on domestic securities and 105 percent of fair value on international securities loaned. Cash collateral is invested in the Retirement System's name in a dedicated short-term investment fund consisting of investment grade debt securities. The System does not have the ability to pledge or sell collateral securities without a borrower default. At June 30, 2003, the maturities of securities in this dedicated bond portfolio are as follows: 73% of the fair value of the securities mature within 30 days; 12% mature between 31 and 180 days; and 15% mature after 180 days. The custodian provides for full indemnification to the Retirement System for any losses that might occur in the event of borrower default. Therefore, the Retirement System does not incur any credit risk as it relates to this activity. The securities on loan are marked to market daily to ensure the adequacy of the collateral. The fair value of securities on loan as of June 30, 2003 was \$ 1,827,580,110 and as of June 30, 2002 was \$ 1,525,751,916. Collateral held by the Retirement System for June 30, 2003 and June 30, 2002 was \$ 1,881,337,715 and \$ 1,568,498,413, respectively. Net income produced from securities lending activities for fiscal year 2003 was \$3,803,825 and for fiscal year 2002 was \$3,310,985.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies (Continued)

Investments (Continued)

The Retirement System's international investment managers utilize forward contracts to hedge the exposure of the international investments to fluctuations in foreign currency. Active international investment managers use forward contracts to enhance returns and/or to control volatility. The Retirement System also contracts with a currency overlay manager to manage the currency exposure to the System's passive international equity portfolio. Currency risk arises due to foreign exchange rate fluctuations. Forward foreign exchange contracts are negotiated between two counterparties. The Retirement System could incur a loss if its counterparties failed to perform pursuant to terms of their contractual obligations. Controls are established by the investment managers to monitor the creditworthiness of the counterparties.

All forward foreign currency contracts are carried at fair value by the Retirement System. As of June 30, 2003, the System had sold forward currency contracts with a fair value of \$ 1,298,196,948 and had bought forward currency contracts with a fair value of \$ 1,310,552,185. Purchases of forward currency contracts are liabilities included in Securities Purchased, and sales of forward currency contracts are receivables included in Sale of Investment Securities in the Statement of Plan Net Assets.

The Retirement System also participates in option contracts. These contractual agreements give the purchaser the right, but not the obligation, to purchase or sell a financial instrument at a specified price within a specified time. Options strategies used by the Retirement System are designed to provide exposures to positive market moves and limit exposure to interest rate and currency fluctuations.

The Retirement System internally manages a Treasury Inflation Protected Securities (TIPS) portfolio. TIPS are fixed income securities issued by the U.S. Treasury that pay a fixed coupon rate plus an adjustment for subsequent inflation. At June 30, 2003, the Retirement System had invested in TIPS with a fair value of approximately \$887,560,000.

The Retirement System's investments are categorized by asset classes to give an indication of the level of risk assumed as of year-end. The categories are as follows:

- (1) Insured or registered and held by the System's custodial bank in the System's name.
- (2) Uninsured and unregistered and held by the counterparty's trust department or agent in the System's name.
- (3) Uninsured and unregistered and held by brokers or dealers not in the System's name.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies (Continued)

Investments (Continued)

All Retirement System investments that can be categorized within these guidelines meet the criteria of category 1, with the exception of investments made with securities lending cash collateral, which meet the criteria of category 3. A security, for purposes of classification in the above categories, is a transferable financial instrument that evidences ownership or creditor status. "Securities" do not include investments made with another party, real estate, or direct investments in mortgages. Investments in mutual funds, limited partnerships, real estate investment trusts and commingled trust funds also are not considered securities for purposes of credit risk classification. Such investments are shown in the schedule below as "not subject to classification." The schedule distributes by asset class the fair values of investments.

	Asset Classification			Fair Value
	1	2	3	
Investments:				
Subject to classification:				
Domestic equities	\$ 2,947,882,010	\$	\$	\$ 2,947,882,010
International equities	1,344,148,484			1,344,148,484
Fixed income	1,841,092,111		313,271,046	2,154,363,157
Short term corporate notes	128,733,438 ⁽¹⁾		1,280,744,486 ⁽²⁾	1,409,477,924
Short term federal agencies	199,429,056 ⁽¹⁾			199,429,056
Foreign currency	16,349,386			16,349,386
Total subject to classification	<u>\$ 6,477,634,485</u>	<u>\$</u>	<u>\$ 1,594,015,532</u>	<u>8,071,650,017</u>
Not subject to classification:				
Alternative investments ⁽³⁾				483,143,921
Real estate				616,124,300
Money market mutual funds				270,498,590
Securities on loan ⁽⁴⁾				<u>1,807,032,928</u>
Total not subject to classification				<u>3,176,799,739</u>
Total investments and invested securities lending collateral				<u>\$ 11,248,449,756</u>

(1) Fixed securities maturing within 90 days of purchase date.

(2) Securities lending cash collateral invested with maturities within 90 days of fiscal year end.

(3) Alternative investments include direct placements and investments in limited partnerships.

(4) Market value of securities loaned, with cash collateral.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies (Continued)

Capital Assets and Supplies Inventory

Furniture, fixtures, and equipment are reported at historical cost, net of accumulated depreciation. These assets are depreciated on a straight-line basis over an average useful life of three to ten years with no salvage value. Accumulated depreciation on furniture, fixtures, and equipment as of June 30, 2003, was \$2,047,493. Office supplies inventory in the amount of \$ 11,288 is included, assuming the first-in, first-out method.

In fiscal year 1999, the Retirement System purchased an office building and parking garage in Topeka, Kansas. Fifty percent of the floor space of the office building is used as the System's administrative headquarters and the remaining fifty percent is a real estate investment. The administrative portion of the building and parking garage are reported on the Statement of Plan Net Assets as a capital asset and are being depreciated. Accumulated depreciation on the administrative portion of the building and garage as of June 30, 2003 was \$ 1,521,083. The office building and garage are being depreciated over a period of 33 years using an accelerated method. The carrying value of the System's administrative headquarters was \$ 2,298,620 as of June 30, 2003 and \$2,602,837 as of June 30, 2002.

Compensated Accrued Absences

Expenses for accumulated vacation and sick leave earned by Retirement System personnel are recorded when earned by the employee. In the event of termination of employment with the State of Kansas, an employee is compensated for vacation benefits accrued in varying amounts ranging from one to 30 days. Compensation for accumulated sick leave requires three conditions to occur: (1) accumulation of 800 hours; (2) minimum of eight years of credited service; and (3) termination with the State of Kansas on or after attainment of retirement age. If all conditions are met, the employee will be compensated in accordance with applicable personnel regulations. The minimum amount of sick leave to be compensated is 30 days; the maximum amount is 60 days.

Reserves

K.S.A. 74-4922, K.S.A. 74-4927 and K.S.A. 74-49,110 define the title and use of the required reserves of the Retirement System. The law governing the Retirement System requires the actuary to make an annual valuation of the Retirement System's liabilities and reserves, to make a determination of the contributions required to discharge the Retirement System's liabilities and to recommend to the Board of Trustees employer contribution rates required to maintain the System on an actuarial reserve basis. The various reserves are:

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies (Continued)

Reserves (Continued)

The Members Accumulated Contribution Reserve represents the accumulation of member contributions plus interest credited to individual member accounts of non-retired members. At the date of retirement the individual member's account is transferred to the Retirement Benefit Payment Reserve. Upon termination of employment and application for withdrawal, refunds of employee contributions plus accumulated interest are charged to this reserve. Interest is credited to active member accounts on June 30 each year, based on the balance in the account as of the previous December 31. The interest crediting rate, defined by statute as the actuarial interest assumption rate, was eight percent (8%) for those who became members prior to July 1, 1993. For those who first became members after June 30, 1993, interest on employee contributions will be credited at the rate of four percent (4%) per year. The balance at June 30, 2003 was \$3,640,595,475 and was fully funded.

The Retirement Benefit Accumulation Reserve represents the accumulation of employer contributions, net investment income not credited to any other reserve, and the actuarially computed prior service liability not yet funded. The balance at June 30, 2003 was \$2,782,812,678 and the unfunded liability was \$2,828,736,438.

The Retirement Benefit Payment Reserve represents the actuarially computed present value of future benefits for retired members plus interest credited for the current fiscal year based upon information as of the preceding January 1. The balance at June 30, 2003 was \$5,247,201,306 and was fully funded.

The Group Insurance Reserve represents employer contributions, which pay 100 percent of the cost of group life insurance and long-term disability coverage. Insurance premiums and benefits consist of (1) claims paid under the insurance contract; and (2) deposits made by the Retirement System to pay disability benefits to eligible participants. An actuarial valuation of this fund was last completed for June 30, 2002. At that time, the fund was 77.5 percent funded with assets of \$ 121.9 million. A moratorium on contributions was in place for the first six months and the last three months of fiscal year 2003. Calendar year 2003 legislation placed another moratorium on contributions to this fund for all of fiscal year 2004. The balance at June 30, 2003 was \$73,072,511, and remains less than fully funded.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL, STATEMENTS (Continued)

2 - Summary of Significant Accounting Policies (Continued)

Reserves (Continued)

The Expense Reserve represents an amount of investment income which is sufficient to maintain a year-end account balance at two times the most recent fiscal year's administrative expense amount. The System's administrative expenses are financed from this reserve. The balance at June 30, 2003 was \$ 14,430,048 and was fully funded.

The Retirant Dividend Payment Reserve balance at June 30, 2003 was \$1,066,741 and was fully funded. K.S.A. 74-49,110 was amended by 2003 legislation to credit this reserve by the amount required to pay an additional monthly benefit to all retirants who retired before July 2, 1987. This credit should occur prior to October 1 of each year.

Budget

The annual budget of the operations of the Retirement System is developed by the staff and approved by the Board of Trustees. It is sent to the State Budget Division for analysis and policy decisions and is included in the governor's budget message to the Legislature. The Legislature adopts appropriation and expenditure limitations. When that process is complete, the Retirement System has an approved budget.

Non-Retirement Funds

The 2000 legislative session assigned to the Retirement System the investment responsibilities of two funds that consist of non-retirement money. K.S.A. 75-5321(a) established the Senior Service Trust Fund and this fund exists solely to provide income to the nursing facility service payment program, the home and community based nursing facility program and the income eligible (home care) program. The Treasurer's Unclaimed Property Fund was established to provide investment earnings available for periodic transfer to the State Treasury for the credit of the State General Fund. During the 2000 legislative session, management of the investments in these funds was transferred to the Retirement System. Legislation was also provided to defray the reasonable expenses of administering these funds. During fiscal year 2003, investments for the Senior Services Trust Fund were liquidated and transferred to the State of Kansas Department on Aging. Investments under management for the Treasurer's Unclaimed Property Fund were \$91,459,105 at June 30, 2003.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

3 - Funding Policy

Funding

The law governing the Retirement System requires the actuary to make an annual valuation of the System's liabilities and reserves and determine the contribution required to discharge the System's liabilities. The actuary then recommends to the System's Board of Trustees the employer contribution rates required to maintain the Retirement System on the actuarial reserve basis.

Every three years, the actuary makes a general investigation of the actuarial experience under the System including mortality, retirement, and employment turnover. The actuary recommends actuarial tables for use in valuations and in calculating actuarial equivalent values based on such investigation. An actuarial experience study was conducted for the three years ending December 31, 2000. As a result of this study, the Board of Trustees adopted new assumptions in regard to retirement rates, mortality, and withdrawal rates.

In fiscal year 1993, the Kansas Legislature passed legislation that amended the Retirement System's statutory funding method. The funding method was changed from the frozen initial liability method to the projected unit credit actuarial cost method. The law also provided that this method be used to determine KPERS employer contribution rates beginning with the 1993 actuarial valuation, except for Board of Regents plan members (TIAA and equivalents). Under the new method, the unfunded actuarial accrued liability is recalculated each year (rather than being essentially fixed in dollar amount as under the previous method). Actuarial gains and losses resulting from differences between actual and assumed experience are reflected in KPERS' accrued actuarial liabilities, and affect the amount of annual amortization payments required to amortize the unfunded accrued liability over the statutory 40-year period from July 1, 1993. The funding methods used by the Retirement System's actuary for the KP&F and the Judges systems were not changed; they were the aggregate cost method with supplemental liability and the frozen initial liability method, respectively.

In fiscal year 2003, the Kansas Legislature passed additional legislation impacting the funding of the Retirement System. Members of the TIAA group (who previously had a separate valuation and contribution rate) were made special member of KPERS. Most of the members were transferred to the State/School group but those employed by the KU Hospital Authority were transferred to the Local group. The legislation effecting this change also provided that bonds will be issued, in addition to a \$ 2 million cash payment, to fully fund the existing unfunded actuarial liability for this group as of December 31, 2002.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

Funding Policy (continued)

Funding (continued)

Also, 2003 legislation made permanent the retirement dividend for members who retired prior to July 2, 1987. Previously, a dividend payment was contingent upon a formula using prior year's investment results. Legislation also provided for bonds to be issued to finance this benefit enhancement for the eligible state retirees. The debt service payments on the bond issue will be paid from an increase in the state's employer contribution rate beginning in fiscal year 2005. The resulting increase in the unfunded actuarial liability for Local employers is to be paid off over a 10-year period, beginning in 2005, by an increase in the employer contribution.

The actuary has estimated the change in the unfunded actuarial liability between December 31, 2001 and December 31, 2002 can be attributed to the following (in millions):

Unfunded Actuarial Liability, December 31, 2001	\$ 1,780
Effect of contribution cap/time lag	143
Excepted increase due to amortization method	21
Loss from investment return	644
Liability experience	68
Changes in benefit provisions (13th check)	37
13th check bond proceeds	(25)
TIAA bond proceeds	(16)
Re-establishment of UAL (KP&F/Judges)	177
	<hr/>
Unfunded Actuarial Liability, December 31, 2002	<u><u>\$ 2,829</u></u>

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

3 - Funding Policy (Continued)

Contributions Required and Contributions Made

KPERS - The actuarially determined contribution rates are computed as a level percentage of payroll by the Retirement System's actuary. For the State/School, Correctional and TIAA members, the results of June 30, 1999 and June 30, 2000 actuarial valuations provide the basis for Board certification of employer contribution rates for fiscal years beginning in 2001 and 2002, respectively. As explained in Note 1, legislation has limited the amounts that employers are required to contribute for State/School employees and Local employees, which has resulted in lower employer contribution rates, as compared to the actuarial determined rates. The actuarially determined employer contribution rates (not including the 0.6% contribution rate for the Death and Disability Program), and the statutory contribution rates for fiscal years 2002 and 2003 are as follows:

Fiscal Year	State/School		Correction Employees		TIAA	
	Actuarial Rate	Statutory Rate	Actuarial Rate	Statutory Rate	Actuarial	Statutory Rate
2002	5.40%	4.18%	6.67/6.84%	5.57/4.99%	1.43%	1.43%
2003	5.57%	4.38%	7.28/7.92%	6.73/6.09%	1.67%	1.67%

The results of June 30, 2000 and December 31, 2000 actuarial valuations provide the basis for Board certification of local employer contribution rates for fiscal years beginning in 2002 and 2003, respectively. The actuarially determined employer contribution rates and statutory contribution rates for fiscal years 2002 and 2003 are as follows:

Fiscal Year	Local	
	Actuarial Rate	Statutory Rate
2002	3.47%	2.92%
2003	4.13%	3.07%

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

3 - Funding Policy (Continued)

Contributions Required and Contributions Made (Continued)

KP&F - The uniform participating service rate for all KP&F employers was 6.79% for the fiscal year beginning in 2002 and 6.86% for the fiscal year beginning in 2003. KP&F employers also make contributions to amortize the liability for past service costs, if any, which are determined separately for each participating employer.

Judges - The total actuarially determined employer contribution rate is 12.48% of payroll for the fiscal year ended 2002 and 12.26% of payroll for the fiscal year ended in 2003.

The law specifies employee contributions as: each participating employer, beginning with the first payroll for services performed after the entry date, shall deduct from the compensation of each member an amount equal to 4% for KPERS members, 7% for KP&F members, and 6% for Judges members as the member's employee contributions. All contributions required to be made have been made as follows:

	(Expressed in Thousands)		
	Employer and Insurance Contributions	Member Contributions ^{'''}	Contributions as a percent of Covered Payroll
KPERS - State/School, TIAA	\$ 162,215	\$ 143,754	8.2%
KPERS - Local	36,336	49,121	7.6%
KP&F	30,317	22,458	20.0%
Judges	2,595	1,110	18.2%
Total	<u>\$ 231,463</u>	<u>\$ 216,443</u>	<u>8.7%</u>

(1) Member Contributions do not include Optional Life Insurance contributions of approximately \$8.3 million.

An estimated \$ 381 million of employer and employee contributions were made to cover normal cost, an estimated \$50 million was made for the amortization of the unfunded actuarial accrued liability, and \$8.6 million for insurance contributions.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

3 - Funding Policy (Continued)

Historical Trend Information

Historical trend information, showing the Retirement System's progress in accumulating sufficient assets to pay benefits when due, is presented on page 32, and is titled "Schedule of Funding Progress."

4 - Commitments and Contingencies

As of June 30, 2003, the Retirement System was committed to additional funding of \$7,027,000 in the form of capital expenditures on separate account real estate holdings in the portfolio, \$379,138,000 for commitments on venture capital investments and \$33,629,000 for capital calls on real estate property trusts investments.

The Retirement System is a defendant in legal proceedings and claims arising out of the ordinary course of business. The Retirement System believes that it has adequate legal defenses and that the ultimate outcome of these actions will not have a material adverse effect on the Retirement System's financial position.

REQUIRED SUPPLEMENTARY INFORMATION

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Fiscal Year Ended June 30, 2003

<u>Year Ended June 30,</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
1994	\$ 117,581,812	100.0%
1995	129,083,585	100.2%
1996 (1)	173,927,737	82.5%
1997	199,521,423	74.7%
1998	216,270,482	77.3%
1999	256,813,541	79.0%
2000	234,941,116	80.6%
2001	277,096,692	77.6%
2002	289,519,647	79.7%
2003	311,365,296	78.9%

- (1) For fiscal years ending June 30, 1996 and after, the actual contributions for KPERS employers were substantially lower than the actuarially required amount, due to statutory limitations on annual increases as discussed in Note 1.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF FUNDING PROGRESS

Fiscal Year Ended June 30,2003

(Dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
613011994 ⁽¹⁾	\$ 5,041,703	\$ 6,546,924	\$ 1,505,221	77%	\$ 3,487,462	43%
613011995	5,510,957	6,991,029	1,480,072	79%	3,766,917	39%
6/30/1996	6,158,755	7,603,111	1,444,356	81%	3,945,207	37%
613011997	6,875,918	8,251,986	1,376,068	83%	4,108,320	33%
613011998	7,749,203	9,340,685	1,591,482	83%	4,273,627	37%
613011999	8,601,876	9,999,246	1,397,370	86%	4,480,717	31%
613012000	9,568,275	10,801,397	1,233,122	89%	4,684,768	26%
12/31/2000 ⁽²⁾	9,835,182	11,140,014	1,304,832	88%	4,876,555	27%
1213112001	9,962,918	11,743,052	1,780,134	85%	5,116,384	35%
1213112002	9,784,862	12,613,599	2,828,736	78%	4,865,903 ⁽³⁾	58%

(1) Asset valuation method was changed from book value to a market-based method.

(2) The actuarial valuation date was changed to a calendar year basis.

(3) Beginning with the 12131102 actuarial valuation, the unfunded actuarial liability of the TIAA group was eliminated. Therefore, covered payroll no longer includes the salaries of non-KPERS unclassified employees of the Board of Regents institutions previously included.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

ACTUARIAL VALUATION

June 30,2003

The information presented in the required supplemental schedule was determined as part of the actuarial valuations at the date indicated. Additional information as of the latest actuarial valuation follows:

	KPERS	KP&F	Judges
Valuation date	12/31/2002	12/31/2002	12/31/2002
Actuarial cost method	Projected Unit Credit	Aggregate Cost with Supplemental Liabilities ⁽²⁾	Frozen Initial Liability
Amortization method	Level Percent closed	Level Percent closed	Level Dollar closed
Remaining amortization period	30 years	30 years	30 years
Asset valuation method	Expected value plus 1/3 of difference between market and expected	Expected value plus 1/3 of difference between market and expected	Expected value plus 1/3 of difference between market and expected

Actuarial assumptions:

Investment rate of return ⁽¹⁾	8%	8%	8%
Projected salary increases ⁽¹⁾	4.0-9.8%	4.0-12.5%	5.5%
Cost of living adjustments	None	None	None

(1) Salary increases and investment rate of return include a 3.5% inflation component.

(2) The aggregate cost method used for KP&F does not directly calculate an unfunded actuarial liability each year. A supplemental liability consisting of the additional actuarial liability for benefits provided by 1993 legislation was established in 1993 and was "frozen". Changes to the unfunded actuarial liability after 1993 reflected only scheduled amortization payments, changes in benefit provisions and assumption changes. As the result of favorable experience from 1993 to 2000 and a change in the actuarial assumptions resulting from the 2001 Experience Study, the supplemental liability was reestablished. The actuarial value of assets exceeds the actuarial liability so the supplemental liability was set to zero. The remaining unfunded actuarial liability amortization bases were established as a result of the 1998 COLA and are being amortized over a 15-year period, beginning in 2000.

SUPPLEMENTARY INFORMATION

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF CONTRIBUTIONS

Fiscal Year Ended June 30,2003

Kansas Public Employees Retirement System

Statel school contributions:

Members	\$ 143,753,593	
Employers	148,604,563	
Insurance*	<u>5,239,088</u>	
Total statel school contributions		\$ 297,597,244

Local contributions:

Members	49,121,161	
Employers	33,893,522	
Insurance*	<u>2,443,227</u>	
Total local contributions		85,457,910

State contributions - KPERS TIAA:

Employers	7,494,774	
Insurance*	<u>876,797</u>	
Total state contributions - KPERS TIAA		<u>8,371,571</u>

Total contributions -

Kansas Public Employees Retirement System \$ 391,426,725

Kansas Police and Firemen's System

State contributions:

Members	2,177,666	
Employers	<u>2,427,390</u>	
Total state contributions		4,605,056

Local contributions:

Members	20,280,476	
Employers	<u>27,889,801</u>	
Total local contributions		<u>48,170,277</u>

Total contributions -

Kansas Police and Firemen's System 52,775,333

Kansas Retirement System for Judges

State contributions:

Members	1,110,297	
Employers	2,572,716	
Insurance*	<u>22,446</u>	
Total state contributions		<u>3,705,459</u>

Total contributions -

Kansas Retirement System for Judges 3,705,459

Member contributions - optional life:

State employees	4,619,116	
Local employees	<u>3,684,137</u>	
Total contributions		<u>8,303,253</u>

Total contributions -

Optional life insurance 8,303,253

Grand total - all contributions

\$ 456,210,770

- Per legislation, employers were not required to remit the Group Life and Disability portion of the actual employer contribution rate from July 1,2002 through December 31,2002 or from April 1,2003 through June 30,2003.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF ADMINISTRATIVE EXPENSES

Fiscal Year Ended June 30,2003

Salaries and wages		\$ 4,255,815
Professional services:		
Actuarial	\$ 244,440	
Audit	42,500	
Data processing	339,910	
Legal	46,060	
Other professional services	<u>292,021</u>	
Total professional services		964,931
Communication:		
Advertising	18,618	
Postage	216,302	
Printing	93,672	
Telephone	<u>85,112</u>	
Total communication		413,704
Building administration:		
Building management	72,656	
Janitorial service	47,607	
Office and equipment rent	21,906	
Real estate taxes	94,050	
Utilities	<u>63,647</u>	
Total building administration		299,866
Miscellaneous:		
Call center	75,200	
Dues and subscriptions	20,370	
Repair and service agreements	138,198	
Supplies	173,116	
Temporary services	130,712	
Travel	105,914	
Other miscellaneous	21,712	
Depreciation	<u>615,486</u>	
Total miscellaneous		<u>1,280,708</u>
Total administrative expenses		<u>\$ 7,215,024</u>

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
SCHEDULE OF INVESTMENT INCOME BY ASSET CLASS

Fiscal Year Ended June 30, 2003

Asset Classification	Interest, Dividends and Other Transactions	Gains and (Losses)	Total
Marketable equity securities:			
Domestic equities	\$ 32,669,209	\$ 10,740,083	\$ 43,409,292
International equities	38,283,246	(150,785,547)	(112,502,301)
Subtotal marketable equities	70,952,455	(140,045,464)	(69,093,009)
Marketable fixed income securities:			
Domestic fixed income:			
Government	60,634,286	213,513,756	274,148,042
Corporate	79,797,293	83,578,577	163,375,870
Subtotal marketable fixed income	140,431,579	297,092,333	437,523,912
Temporary investments	4,202,916	593,727	4,796,643
Total marketable securities	215,586,950	157,640,596	373,227,546
Real estate	31,217,255	6,828,360	38,045,615
Alternative investments	6,332,696	(79,235,477)	(72,902,781)
Total real estate and alternative investments	37,549,951	(72,407,117)	(34,857,166)
Other investment income:			
Securities lending	3,803,825		3,803,825
Recaptured broker commissions	371,927		371,927
Miscellaneous income	185,684		185,684
Total other investment income	4,361,436		4,361,436
Total investment income	<u>\$ 257,498,337</u>	<u>\$ 85,233,479</u>	<u>342,731,816</u>
Manager and custodian fees and expenses:			
Investment manager fees			(15,080,751)
Custodian fees and expenses			(798,753)
Other investment expenses			(795,669)
Total investment fees and expenses			<u>(16,675,173)</u>
Net investment income			<u>\$ 326,056,643</u>

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF INVESTMENT FEES AND EXPENSES

Fiscal Year Ended June 30, 2003

Domestic equity managers:		
Barclays Global Investors	\$ 2,109,735	
Capital Guardian Trust Co.	404,028	
Wellington Management Co.	1,684,805	
Subtotal domestic equity managers		\$ 4,198,568
International equity managers:		
Alliance Capital Management	774,027	
Lazard Freres Asset Management	1,272,499	
Morgan Stanley Asset Management	1,234,739	
Nomura Capital Management	502,703	
Subtotal international equity managers		3,783,968
Fixed income managers:		
Loomis, Sayles & Co.	1,198,267	
Pacific Investment Management Co.	1,037,066	
Payden & Rygel Investment Counsel	774,769	
Western Asset Management Co.	744,074	
Subtotal fixed income managers		3,754,176
Foreign currency overlay manager:		
Pareto Partners	1,073,334	
Subtotal foreign currency overlay manager		1,073,334
Real estate and alternative investment managers:		
Lend Lease	1,511,568	
Portfolio Advisors	667,320	
Subtotal real estate and alternative investment managers		2,178,888
Cash equivalent manager:		
Payden & Rygel Investment Counsel	91,817	
Subtotal cash equivalent manager		91,817
Total investment management fees		15,080,751
Other fees and expenses:		
Mellon Trust - custodian fees and expenses	798,753	
Consultant fees	682,842	
Litigation expenses	112,827	
Subtotal other fees and expenses		1,594,422
Total investment fees and expenses		\$ 16,675,173

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

INVESTMENT SUMMARY (In Thousands)'

Fiscal Year Ended June 30,2003

	June 30, 2002 Fair Value	Purchases and Other Increases	Sales and Other Decreases	June 30, 2003 Fair Value	Asset Mix Fair Value
Marketable securities:					
Domestic equities	\$ 2,832,120	\$ 908,699	\$ (716,238)	\$ 3,024,581	32.22%
International equities	1,449,505	802,401	(630,373)	1,621,533	17.27%
Total fixed income	3,496,031	9,251,890	(9,492,421)	3,255,500	34.68%
Temporary investments ⁽²⁾	349,883	22,300,247	(22,270,366)	379,764	4.04%
Total marketable securities	8,127,539	33,263,237	(33,109,398)	8,281,378	88.21%
Real estate and alternative investments:					
Real estate	689,739	70,183	(136,274)	623,648	6.64%
Direct placements and limited partnerships	483,148	214,758	(214,762)	483,144	5.15%
Total real estate and alternative investments	1,172,887	284,941	(351,036)	1,106,792	11.79%
Total investments	\$ 9,300,426	\$ 33,548,178	\$ (33,460,434)	\$ 9,388,170	100.00%

(1) **Amounts** include changes in unrealized appreciation and excludes interest and dividend accruals. **Amounts** exclude security lending cash collateral of \$ 1,860,279,374 and \$ 1,544,443,171 for fiscal years 2003 and 2002, respectively.

(2) Temporary investments include foreign currencies and securities maturing within 90 days of purchase date.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

EXPENSES BY TYPE

Fiscal Year Ended June 30,2003

Fiscal Year	Benefits	Withdrawals	Insurance	Administration	Total
1994	\$ 292,375,535	\$ 22,900,621	\$ 33,129,180	\$ 3,596,637	\$ 352,001,973
1995	333,924,392	26,542,254	35,873,212	4,312,658	400,652,516
1996	364,102,629	30,687,458	34,108,251	4,493,293	433,391,631
1997	396,660,948	36,761,626	36,048,625	4,659,099	474,130,298
1998	428,997,161	41,510,908	37,639,743	4,702,566	512,850,378
1999	472,571,948	40,860,950	41,892,190	5,442,410	560,767,498
2000	505,941,764	43,631,850	42,199,878	5,689,571	597,463,063
2001	558,901,552	43,967,623	46,456,603	6,843,434	656,169,212
2002	636,398,865	39,066,937	47,625,764	6,776,044	729,867,610
2003	653,542,143	39,608,946	53,829,235	7,215,024	754,195,348

CASH RECEIPTS AND DISBURSEMENTS

Fiscal Year Ended June 30,2003

Opening cash balance		\$ 147,584
Member contributions	\$ 216,810,990	
Employer contributions	231,481,607	
System recoveries	75,058	
Refund of advancements	624,847,000	
Optional life insurance	8,209,836	
Other	7,199	
Total cash receipts		1,081,431,690
Withdrawal of contributions	34,722,470	
Payment to beneficiaries	13,643,082	
Retirement benefits	638,607,143	
Retirant dividend payments	7,217,449	
Group life insurance premiums	12,345,601	
Optional life insurance premiums	8,254,860	
Electronic funds transfer	33,507	
Administrative expenses	6,576,639	
Deposited with insurance carrier	31,900,000	
Advanced to investment custodian	311,113,846	
Investment manager fees and expenses	17,117,170	
Total disbursements made		1,081,531,767
Ending cash balance		\$ 47,507



Berberich Trahan & Co., P.A.

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

Legislative Post Audit Committee
Kansas State Legislature:

We have audited the financial statements of the Kansas Public Employees Retirement System as of and for the year ended June 30, 2003, and have issued our report thereon dated September 9, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

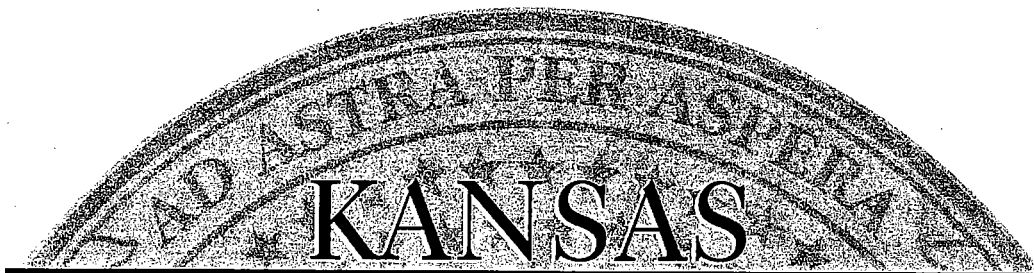
Internal Control Over Financial Reporting

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

This report is intended solely for the information and use of Legislative Post Audit, the Board of Trustees and management. This restriction is not intended to limit the distribution of this report, which upon acceptance by Legislative Post Audit, is a matter of public record.

Berberich Trahan & Co., P.A.

September 9, 2003



KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

KATHLEEN SEBELIUS, GOVERNOR

December 5, 2003

Brad Koehn
Berberich Trahan & Co., P.A.
3630 SW Burlingame Rd
Topeka KS 66611-2050

Dear Mr. Koehn:

Thank you for the opportunity to formally respond to the draft copy of your completed financial and compliance audit report. The Retirement System appreciated the professional approach taken by your firm during this audit.

We are pleased that the report contains no findings or recommendations in regard to accounting procedures or internal controls. The Retirement System is also pleased to acknowledge the unqualified auditor's opinion contained in the report.

This year's report again emphasizes certain matters contained in the financial statements that require additional discussion and analysis. These matters include the difference in the actuarial recommended employer contribution rates and the statutorily capped contribution rates and the growth in the System's unfunded actuarial liability.

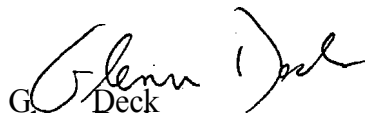
During the past two years, our objective has been to develop a consensus among the Board of Trustees, Legislature and Governor on a comprehensive funding plan to ensure the System's financial health. To that end, we have worked closely with the Joint Committee on Pensions, Investments and Benefits to analyze the problem and develop a range of funding alternatives.

The passage of HB 2014 during the 2003 Legislative Session providing employer contribution rate increases was a significant initial step toward restoring the State/School group's long-term financial health. During the 2003 Interim the Joint Committee has devoted considerable time to a study topic on KPERS long-term funding. At its December 1, 2003 meeting, the Joint Committee approved a recommendation to the State Finance Council for the issuance of \$500 million in pension obligation bonds to be utilized to fund a portion of the KPERS State/School group's unfunded actuarial liability. In addition, the Joint Committee adopted the Board of Trustees' recommendations to introduce legislation in 2004 to raise the KPERS Local group's employer contribution rates and to address certain actuarial issues.

If these recommendations are implemented they will result in continued progress in improving the financial status of the System. However, as the Joint Committee noted in its deliberations, additional work remains on other portions of the comprehensive funding plan to ensure the System's long-term financial health. The System looks forward to continuing to work with the Legislature and Governor in the development and implementation of this plan.

We look forward to discussing the completed audit report with the Legislative Post Audit Committee.

Sincerely,


Glenn Deck

Executive Director

Cc: Randy Tongier, Audit Manager
Legislative Division of Post Audit