



# **FINANCIAL AND COMPLIANCE AUDIT REPORT**

**Kansas Public Employees Retirement System  
Fiscal Year 2008**

**A Report to the Legislative Post Audit Committee  
By the joint venture of Allen Gibbs & Houlik and  
Berberich Trahan & Co., audit firms under contract with the  
Legislative Division of Post Audit  
State of Kansas  
December 2008**

# ***Legislative Post Audit Committee***

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## ***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 \$13 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 governmental 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. Government Accountability Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also 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 Minority Leader.

Audits are performed at the direction of the Legislative Post Audit Committee. Legislators

or committees should make their requests for performance audits through the Chairman or any other member of the Committee. Copies of all completed performance audits are available from the Division's office.

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Barbara J. Hinton, Legislative Post Auditor

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The Legislative Post Audit Committee and the Legislative Division of Post Audit have launched an initiative to identify ways to help make State government more efficient. If you have an idea to share with us, send it to [ideas@lpa.state.ks.us](mailto:ideas@lpa.state.ks.us), or write to us at the address above.

You won't receive an individual response, but all ideas will be reviewed, and Legislative Post Audit will pass along the best ones to the Legislative Post Audit Committee.

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LEGISLATURE OF KANSAS



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December 19, 2008

To: Members, Legislative Post Audit Committee

Senator Derek Schmidt, Chair  
Senator Les Donovan  
Senator Anthony Hensley  
Senator Nick Jordan  
Senator Chris Steineger

Representative Virgil Peck, Jr., Vice-Chair  
Representative Tom Burroughs  
Representative John Grange  
Representative Peggy Mast  
Representative Tom Sawyer

This report contains significant findings, conclusions, and recommendations from the completed financial-compliance audit of the Kansas Public Employees Retirement System covering fiscal year 2008. This audit was conducted by the joint venture of Allen Gibbs & Houlik and Berberich Trahan & Co., certified public accounting firms under contract with the Legislative Division of Post Audit.

We would be happy to discuss this report with any legislative committees, individual legislators, or other State officials.

  
Barbara J. Hinton  
Legislative Post Auditor



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*Certified Public Accountants*

# KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

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FINANCIAL AND COMPLIANCE AUDIT REPORT  
YEAR ENDED JUNE 30, 2008

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

FINANCIAL AND COMPLIANCE AUDIT REPORT

Year Ended June 30, 2008

TABLE OF CONTENTS

	<u>Page</u>
Introduction	1
Schedule of Findings and Recommendations	2
Independent Auditors' Report	3 - 4
Management's Discussion and Analysis	5 - 11
Basic Financial Statements:	
Statement of Plan Net Assets	12
Statement of Changes in Plan Net Assets	13
Notes to Basic Financial Statements	14 - 41
Required Supplementary Information:	
Schedule of Employer Contributions – Retirement Plan	42
Schedule of Funding Progress – Retirement Plan	43
Schedule of Employer Contributions – Death and Disability Plan	44
Schedule of Funding Progress – Death and Disability Plan	45
Supplementary Information:	
Schedule of Contributions	46
Schedule of Administrative Expenses	47
Schedule of Investment Income by Asset Class	48
Schedule of Investment Fees and Expenses	49
Investment Summary	50
Expenses by Type	51
Cash Receipts and Disbursements	52
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	53 - 54

## 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. 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.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

Year Ended June 30, 2008

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of the Kansas Public Employees Retirement System.
2. No material weaknesses relating to the audit of the financial statements are reported in the 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*.
3. No instances of noncompliance material to the financial statements of the Kansas Public Employees Retirement System were disclosed during the audit.

B. FINDINGS – FINANCIAL STATEMENT AUDIT

None.

C. PRIOR YEAR FINDINGS

None.

## 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 (the System), a component unit of the State of Kansas, as of June 30, 2008, 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. The prior year summarized comparative information has been derived from the System's 2007 financial statements and, in our report dated December 6, 2007, we expressed an unqualified opinion on those financial statements.

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

In our opinion, the 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, 2008, 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 our report dated December 17, 2008 on our consideration of the System's internal control over financial reporting and on our tests on its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 5 through 11 and the Required Supplementary Information on pages 42 through 45 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The supplementary information included on pages 46 through 52 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This supplementary information has been subjected to the auditing procedures applied in the 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.

*Allen, Gibbs & Houlik, L.C.*

*Berberich Trahan & Co., P.A.*

December 17, 2008

## **Management's Discussion & Analysis**

This section presents management's discussion and analysis of the Kansas Public Employees Retirement System financial performance during the fiscal year that ended June 30, 2008.

The Kansas Public Employees Retirement System (KPERS, 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 Kansas public employees. The Kansas Retirement System for Judges is a single employer group, while the other two are multi-employer, cost-sharing groups. The State of Kansas and Kansas school districts are required to participate, whereas participation by local political subdivisions is optional but irrevocable once elected.

### **Financial Highlights**

The System's net assets decreased by \$990 million or 7.0 percent from \$14,183,072,962 to \$13,193,063,915.

As of December 31, 2007, the date of the most recent actuarial valuation, the Retirement System's funded ratio was 70.8 percent compared with a funded ratio of 69.4 percent for the prior year.

The unfunded actuarial liability increased from \$5.364 billion at December 31, 2006, to \$5.552 billion at December 31, 2007.

On a market value basis, this year's investment return rate was negative 4.4 percent, compared with last year's return of positive 18.0 percent.

Retirement benefits paid to retirees and beneficiaries increased 8.2 percent from \$868 million in fiscal year 2007 to \$946 million in fiscal year 2008.

### **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 the financial statements
- 3) Required supplementary information
- 4) Supplementary information

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

## **Basic Financial Statements**

A Statement of Plan Net Assets as of June 30, 2008, and a Statement of Changes in Plan Net Assets for the fiscal year ended June 30, 2008, are presented with the 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.

## **Notes to the Basic Financial Statements**

The financial statement notes provide additional information that is essential to a full understanding of the data provided in the financial statements. Information available in the notes to the 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 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. Note 2 also contains 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 Fund, the Expense Reserve and the Optional Term Life Insurance Reserve.

**Note 3** provides information about System funding policies and employer contributions made to the System by the three different funding groups.

**Note 4** provides information about other post employment benefits that the System administers. The Governmental Accounting Standards Board issued GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, that went into effect for periods beginning after December 15, 2005. As part of the reporting requirements declared by this statement, the financial status and activity of the KPERS Death and Disability Plan are displayed separately in the Statement of Net Assets and the Statement of Changes in Plan Net Assets. Required supplemental schedules display the funded status and funding progress of the plan, and the significant methods and assumptions used. As noted in the funding status schedules, the KPERS group insurance reserve fund is 7.2% funded as of June 30, 2007, the last date of the actuarial valuation of the Death and Disability Plan.

**Note 5** describes System capital expenditure commitments to real estate and alternative investments. This section also generally describes potential System contingencies.

## **Required Supplementary Information**

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

## Supplementary Information

Supplementary information includes 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 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, 2008, amounted to \$13,193,063,915, a decrease of \$990 million, 7.0 percent, from \$14,183,072,962 at June 30, 2007. Following are two summary schedules, Plan Net Assets and Changes in Plan Net Assets, comparing information from fiscal years 2007 and 2008.

### Summary Comparative Statements of Plan Net Assets

	As of June 30, 2008	As of June 30, 2007	Percentage Change
<b>Assets</b>			
Cash and deposits	\$ 406,994	\$ 270,888	50.24 %
Receivables	3,156,838,475	3,869,770,192	(18.42)
Investments at fair value	13,527,063,862	14,718,055,888	(8.09)
Invested securities lending collateral	2,205,187,750	2,418,559,400	(8.82)
Capital assets and supplies inventory	6,668,232	5,978,120	11.54
<b>Total assets</b>	<b>18,896,165,313</b>	<b>21,012,634,488</b>	<b>(10.07)</b>
<b>Liabilities</b>			
Administrative costs	602,913	678,339	(11.12)
Benefits payable	1,207,447	3,050,261	(60.41)
Securities purchased	3,484,042,240	4,407,273,526	(20.95)
Securities lending collateral	2,217,248,798	2,418,559,400	(8.32)
<b>Total liabilities</b>	<b>5,703,101,398</b>	<b>6,829,561,526</b>	<b>(16.49)</b>
<b>Net assets</b>	<b>\$ 13,193,063,915</b>	<b>\$ 14,183,072,962</b>	<b>(6.98) %</b>

## Summary Comparative Statements of Changes in Plan Net Assets

	Year Ended June 30, 2008	Year Ended June 30, 2007	Percentage Change
<b>Additions</b>			
Contributions	\$ 727,755,738	\$ 655,813,288	10.97 %
Net investment income (loss)	(652,406,020)	2,158,024,931	(130.23)
Net income from securities lending activities	3,303,038	4,056,541	(18.58)
Total net investment income (loss)	(649,102,982)	2,162,081,472	(130.02)
Other miscellaneous income	225,736	228,986	(1.42)
Total additions	78,878,492	2,818,123,746	(97.20)
<b>Deductions</b>			
Monthly retirement benefits	945,704,657	868,179,029	8.93
Refunds of contributions	48,472,690	46,129,211	5.08
Death benefits	8,388,935	9,153,582	(8.35)
Insurance premiums and disability benefits	56,718,131	55,585,886	2.04
Administrative expenses	9,603,126	8,893,544	7.98
Total deductions	1,068,887,539	987,941,252	8.19
Net increase (decrease)	(990,009,047)	1,830,182,494	(154.09)
Net assets, beginning of year	14,183,072,962	12,352,890,468	14.82
Net assets, end of year	\$ 13,193,063,915	\$ 14,183,072,962	(6.98) %

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 Retirement System increased from \$655.9 million in fiscal year 2007 to \$727.8 million in fiscal year 2008.

The System recognized a net investment loss of \$649 million for the 2008 fiscal year, compared with a net investment gain of \$2.162 billion for the 2007 fiscal year. Total return for the portfolio was a negative 4.4 percent compared with the benchmark return of negative 3.3 percent. System net investments amounted to \$13.127 billion at June 30, 2008, which was \$981 million less than the \$14.108 billion in total System investments at June 30, 2007. 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.

One Year	Latest Three Years	Latest Five Years	Latest Ten Years	Assumed Rate of Return
-4.43%	8.21%	10.39%	6.66%	8%

At June 30, 2008, the System held \$7.0 billion in U.S. equity and international equity securities, a decrease of approximately \$1.2 billion from the 2007 fiscal year. U.S. equity and international equity securities earned returns of approximately negative 13.8 percent and negative 5.9 percent, respectively, for the 2008 fiscal year. These compare with the Retirement System's benchmark returns of negative 12.7 percent and negative 6.2 percent, respectively.

The System held \$4.7 billion in U.S. debt and international debt securities, an increase of \$137 million from the 2007 fiscal year. The TIPS portfolio return for 2008 was 15.4 percent, matching the benchmark return of 15.4 percent. The performance of the System's other fixed income securities during fiscal year 2008 was 5.1 percent compared with the benchmark of 6.2 percent. Real estate investments decreased \$66 million to \$956 million at June 30, 2008. Real estate investments returned approximately negative 3.5 percent for the 2008 fiscal year, versus the benchmark real estate return of 5.3 percent. The System held \$403 million in alternative investments, which was a \$51 million decrease from June 30, 2007. Alternative investments earned a return of approximately 9.3 percent for the 2008 fiscal year, compared to the benchmark alternative investment return of negative 6.5 percent. At June 30, 2008, the System held \$489.3 million in short-term investments, which was an increase of \$45.3 million from June 30, 2007.

The Retirement 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 2008, net securities lending income amounted to \$3.3 million compared with \$4.1 million in fiscal year 2007.

Deductions from net assets held in trust for benefits include retirement, death and survivor benefits, and administrative expenses. For the 2008 fiscal year, retirement, death and insurance benefits amounted to \$1,059.3 million, an increase of \$80.3 million, 8.2 percent, from the 2007 fiscal year. The increase in benefit payments was a result of an increase in the number of retirees. For the 2008 fiscal year, System administrative expenses amounted to \$9.603 million compared with \$8.894 million in fiscal year 2007. This increase was mainly due to costs associated with developing and securing the System's new information system. The ratio of System administrative expenses to the number of members (approximately \$43 per member) continues to be very cost-efficient compared to other statewide retirement plans.

### **Retirement Funding Status**

The 1993 Kansas Legislature improved KPERS benefits and adopted a 40-year payment plan that gradually increased employer contributions to pay for the enhancements. By the early 2000s, it became apparent that the planned rate increases were insufficient to fund those benefits, creating a long-term funding problem. Over the last seven years, the Retirement System's Board of Trustees, staff and actuary have worked closely with the Legislature's Joint Committee on Pensions, Investments and Benefits and the Governor's office to implement a comprehensive funding plan. Key steps taken to implement the plan include:

- A series of scheduled employer contribution rate increases.
- Issuing pension obligation bonds.
- Making actuarial changes.
- Adoption of plan design changes for future employees.

All key steps were implemented with significant success through 2007. In addition, the System's average annual investment performance for calendar years 2003 to 2007 was 11 percent. Funding improvements garnered from the plan implementation, coupled with positive investment results, brought the Retirement System into actuarial balance. However, continued positive funding projections hinged on meeting or exceeding the System's assumed investment target of 8 percent and employer contributions continuing to increase until they met the actuarially required rate.

### Latest Actuarial Projections

In the Retirement System's most recent actuarial valuation dated, December 31, 2007, our consulting actuary reported that the funding condition is close to what we expected. According to that valuation, the System remained in actuarial balance and the unfunded actuarial liability (UAL) increased from \$5.36 billion as of December 31, 2006 to \$5.55 billion as of December 31, 2007. The UAL will continue to increase until statutory employer contribution rates catch up with the actuarially required contribution (ARC) rates. The System's overall funding ratio increased to 70.8 percent.

	<u>UAL</u> <u>(in millions)</u>	<u>Funded</u> <u>Ratio</u>
Kansas Public Employees Retirement System		
KPERS State Group	\$ 451	87%
KPERS School Group	3,862	63%
KPERS Local Group	940	70%
Kansas Police and Firemen's Retirement System	284	86%
Kansas Retirement System for Judges	15	89%
<b>Retirement System Overall Total</b>	<b>\$ 5,552</b>	<b>71%</b>

Negative investment returns since the December 31, 2007, valuation have had a substantial impact on the Retirement System's long-term funding outlook. Unprecedented negative returns through the fourth quarter of calendar year 2008 have been especially damaging due to the ongoing global economic crisis. The funding status of all coverage groups has been affected. Management expects the School group to be out of actuarial balance within the current amortization period, given the current actuarial assumptions and scheduled rate of contributions. Options for increasing employer contributions need to be considered to bring the System back into actuarial balance.

Even with a strong, sustained market recovery, the UAL will significantly increase and the System's funded ratio will decline. This year's negative returns will be averaged in over the next five years, offsetting part of the loss. In addition, KPERS' portfolio is carefully diversified across several asset classes and has the benefit of a steady, long-term investment strategy to help weather the ups and downs of the market over time. As an institutional investor, KPERS' time horizon is longer than most investors. Actual investment returns over the next few years will determine exactly how much funding will be affected and how much the UAL will increase.

The Retirement System's Board of Trustees and staff will continue to closely monitor investment returns and funding status. In addition, they plan to work with the Legislature and Governor to recommend needed adjustments to protect the long-term financial health of the Retirement System and to secure funds for all future benefit payments.

## **Funding and Member Benefits**

All current and future KPERS retirement benefits are dependable and guaranteed by the State of Kansas. Neither the unfunded actuarial liability nor the funding status alters the State's obligation to pay promised benefits to current members. KPERS will continue to work on behalf of our members to advocate policies that provide for the health and stability of the Retirement System.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

STATEMENT OF PLAN NET ASSETS

June 30, 2008  
With Comparative Totals for June 30, 2007

	KPERS Fund	Group Death and Disability Fund	Total 2008	Total 2007
<u>ASSETS</u>				
Cash and deposits:				
Cash	\$ 67,124	\$ 202,660	\$ 269,784	\$ 270,888
Deposits with insurance carrier	-	137,210	137,210	-
Total cash and deposits	67,124	339,870	406,994	270,888
Receivables:				
Contributions	63,709,150	9,525,035	73,234,185	72,712,122
Investment income	56,270,943	59,360	56,330,303	52,665,604
Sale of investment securities	3,027,273,987	-	3,027,273,987	3,744,392,466
Total receivables	3,147,254,080	9,584,395	3,156,838,475	3,869,770,192
Investments at fair value:				
Domestic equities	3,941,009,919	-	3,941,009,919	4,615,179,896
International equities	3,053,973,317	-	3,053,973,317	3,636,724,650
Cash and equivalents	456,614,796	32,655,428	489,270,224	443,921,954
Fixed income	4,683,905,223	-	4,683,905,223	4,546,613,610
Alternative investments	403,318,841	-	403,318,841	454,022,428
Real estate	955,586,338	-	955,586,338	1,021,593,350
Total investments at fair value	13,494,408,434	32,655,428	13,527,063,862	14,718,055,888
Invested securities lending collateral	2,205,187,750	-	2,205,187,750	2,418,559,400
Capital assets and supplies inventory	6,668,232	-	6,668,232	5,978,120
Total assets	18,853,585,620	42,579,693	18,896,165,313	21,012,634,488
<u>LIABILITIES</u>				
Administrative costs	602,913	-	602,913	678,339
Benefits payable	1,088,312	119,135	1,207,447	3,050,261
Securities purchased	3,484,042,240	-	3,484,042,240	4,407,273,526
Securities lending collateral	2,217,248,798	-	2,217,248,798	2,418,559,400
Total liabilities	5,702,982,263	119,135	5,703,101,398	6,829,561,526
Net assets held in trust for pension benefits and other post employment benefits (schedules of funding progress for the plans are presented on page 43 and 45, respectively)				
	\$ 13,150,603,357	\$ 42,460,558	\$ 13,193,063,915	\$ 14,183,072,962

See accompanying notes to basic financial statements.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

STATEMENT OF CHANGES IN PLAN NET ASSETS

Fiscal Year Ended June 30, 2008  
With Comparative Totals for Fiscal Year Ended June 30, 2007

	KPERS Fund	Group Death and Disability Fund	Total 2008	Total 2007
Additions:				
Contributions:				
Member contributions	\$ 269,603,155	\$ -	\$ 269,603,155	\$ 256,995,275
Employer contributions	395,752,213	62,400,370	458,152,583	398,818,013
Total contributions	665,355,368	62,400,370	727,755,738	655,813,288
Investments:				
Net appreciation (depreciation) in fair value of investments	(1,012,601,549)	-	(1,012,601,549)	1,816,702,680
Interest	211,727,774	968,222	212,695,996	195,760,216
Dividends	137,983,566	-	137,983,566	136,434,906
Real estate income, net of operating expenses	40,288,418	-	40,288,418	39,114,763
Other investment income	264,000	-	264,000	261,734
	(622,337,791)	968,222	(621,369,569)	2,188,274,299
Less investment expense	(31,029,901)	(6,550)	(31,036,451)	(30,249,368)
Net investment income (loss)	(653,367,692)	961,672	(652,406,020)	2,158,024,931
From securities lending activities:				
Securities lending income	95,645,344	-	95,645,344	125,998,402
Securities lending expenses:				
Borrower rebates	(89,471,546)	-	(89,471,546)	(120,938,041)
Management fees	(2,870,760)	-	(2,870,760)	(1,003,820)
Total securities lending activities expenses	(92,342,306)	-	(92,342,306)	(121,941,861)
Net income from securities lending activities	3,303,038	-	3,303,038	4,056,541
Total net investment income (loss)	(650,064,654)	961,672	(649,102,982)	2,162,081,472
Other miscellaneous income	136,955	88,781	225,736	228,986
Total additions	15,427,669	63,450,823	78,878,492	2,818,123,746
Deductions:				
Monthly retirement benefits paid	(945,704,657)	-	(945,704,657)	(868,179,029)
Refunds of contributions	(48,472,690)	-	(48,472,690)	(46,129,211)
Death benefits	(8,388,935)	-	(8,388,935)	(9,153,582)
Insurance premiums and disability benefits	(6,824,361)	(49,893,770)	(56,718,131)	(55,585,886)
Administrative expenses	(9,253,050)	(350,076)	(9,603,126)	(8,893,544)
Total deductions	(1,018,643,693)	(50,243,846)	(1,068,887,539)	(987,941,252)
Net increase (decrease)	(1,003,216,024)	13,206,977	(990,009,047)	1,830,182,494
Net assets held in trust for pension benefits and other post employment benefits:				
Balance, beginning of year	14,153,819,381	29,253,581	14,183,072,962	12,352,890,468
Balance, end of year	\$ 13,150,603,357	\$ 42,460,558	\$ 13,193,063,915	\$ 14,183,072,962

See accompanying notes to basic financial statements.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2008

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. The State of Kansas and Kansas schools are required to participate, while 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	29	-
Cities	361	55	-
Townships	54	-	-
School Districts	296	-	-
Libraries	121	-	-
Conservation Districts	83	-	-
Extension Councils	74	-	-
Community Colleges	19	-	-
Educational Cooperatives	23	-	-
Recreation Commissions	42	1	-
Hospitals	29	-	-
Cemetery Districts	12	-	-
Other	176	-	-
	1,396	86	1
Total	1,396	86	1

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&amp;F</u>	<u>Judges</u>	<u>Total</u>
Retirees and beneficiaries currently receiving benefits	64,188	3,782	181	68,151
Terminated employees entitled to benefits but not yet receiving them	9,623	132	14	9,769
Inactive members, deferred disabled	2,911	175	-	3,086
Inactive members not entitled to benefits	27,517	1,011	-	28,528
Current employees	<u>146,406</u>	<u>7,137</u>	<u>261</u>	<u>153,804</u>
Total	<u><u>250,645</u></u>	<u><u>12,237</u></u>	<u><u>456</u></u>	<u><u>263,338</u></u>

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, age 50 with 25 years, or any age with 32 years of service). Monthly retirement benefits are based on a statutory formula that includes final average salary and years of service. When ending employment, members may withdraw their contributions from their individual accounts, including interest. Members who withdraw their accumulated contributions lose all rights and privileges of membership. For all pension coverage groups, the accumulated contributions and interest are deposited into and disbursed from the membership accumulated reserve fund as established by K.S.A. 74-4922.

# KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

## NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

### 1 - Plan Description (Continued)

#### Plan Benefits (Continued)

Members choose one of seven payment options to receive their monthly retirement benefits. At retirement a member may receive a lump-sum payment of up to 50% of the actuarial present value of the member's lifetime benefit. His or her monthly retirement benefit is then permanently reduced based on the amount of the lump sum. Benefit increases, including ad hoc post-retirement benefit increases, must be passed into law by the Kansas Legislature. Benefit increases are under the authority of the Legislature and the Governor of the State of Kansas. For all pension coverage groups, the retirement benefits are disbursed from the retirement benefit payment reserve fund as established by K.S.A. 74-4922.

Active members (except KP&F members) are covered by basic group life insurance. The life insurance benefit is 150% of the annual compensation rate 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). 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 plan. Since 2006, annual disability income benefits have been based on 60% 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. Members who were approved for disability benefits before 2006 have an annual benefit based on 66 percent of the annual compensation at the time of disability. For both groups, the minimum monthly benefit is \$ 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 be eligible for 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 Retirement System reserves. Member contribution rates are established by state law and are paid by the employee 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. The contributions and assets of all three systems are deposited in the Kansas Public Employees Retirement Fund established by K.S.A. 74-4921. 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 a statutory limit of 0.1% of payroll on increases in the contribution rates for KPERS employers. 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 limit increases to 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 increased 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. Legislation passed in 2004 amended the annual increases in future years for local employers. The statutory cap for the Local group increased to 0.4% in calendar 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.

### 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 elected State Treasurer. The Board of Trustees appoints the executive director, who is the Retirement System's managing officer.

# KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

## NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

### 2 - Summary of Significant Accounting Policies (Continued)

#### Other Employee Benefit Plan

The Board of Trustees of the Retirement System has oversight responsibility, but little administrative involvement and no investment responsibility, for the Kansas Public Employees' Deferred Compensation Plan (IRC Section 457) for state employees. Because the Board of Trustees neither owns the assets nor has custody of them and their financial transactions are not recorded in the System's accounting system, this program is not included in the System's financial statements.

#### Measurement Focus and Basis of Accounting

The Retirement System's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Contributions are due to KPERS when employee services have been performed and paid. Contributions are recognized as revenues when due pursuant to statutory requirements. Benefits and refunds are recognized when due and payable and expenses are recorded when the corresponding liabilities are incurred, regardless of when contributions are received or payment is made.

#### Use of Estimates

The Retirement System's financial statement preparation conforms with accounting principles generally accepted in the United States. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities. This also includes disclosing 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.

#### Comparative Financial Information

The basic financial statements include certain prior-year summarized comparative information in total but not at the level of detail required for a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the System's financial statements for the year ended June 30, 2007, from which the summarized information was derived.

# KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

## NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

### 2 - Summary of Significant Accounting Policies (Continued)

#### Cash and Deposits

Custodial credit risk is when in the event a financial institution or counterparty fails, the Retirement System would not be able to recover the value of deposits that are in the possession of an outside party. The System advances cash deposits to a disability administrator for monthly disability benefits and death benefits for members who are disabled. As of June 30, 2008, the Retirement System's deposits with its disability administrator were \$ 137,210. The Retirement System does not have a deposit policy for custodial credit risk associated with these deposits.

#### Method Used to Value Investments

Investments are reported at fair market 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. Fair value of other securities is determined by the means of the most recent bid and asked prices as obtained from dealers that make markets in such securities. Fair values of the limited partnership investments are based on valuations of the underlying companies of the limited partnerships as reported by the general partner. Fair value of the commingled funds are determined based on the underlying asset values.

#### 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 Retirement System's investment program 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% 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)

- The annual allowance for new alternative (non-publicly traded) investments is limited to 1% of the market value of the total investment assets of the fund as measured from the end of the preceding calendar year.
- Establishes limits on the structure of future investments in real estate or alternative investments.
- Requires that the Board develop investment policies and objectives to invest fund assets.
- Authorizes the Board to hire qualified professionals/firms to assist in investing the fund and requires 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.

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 fair 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, 2008, the Retirement System had futures contracts with market exposure of approximately \$ 2,041,600,000. Cash equivalents and short-term investments in amounts necessary to settle the economic value of the futures contracts were held in the portfolio so that no leverage was employed, in accordance with the Statement of Investment Policy.

The Retirement System's Statement of Investment Policy authorizes participation in a securities lending program administered by the 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 types 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% of fair value on domestic securities and 105% 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, 2008, the maturities of securities in this dedicated bond portfolio are as follows: 44% of the fair value of the securities mature within 30 days; 26% mature between 31 and 180 days; and 30% 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 was \$ 2,771,834,583 and \$ 2,484,327,454 as of June 30, 2008 and 2007, respectively. Collateral held by the Retirement System was \$ 2,878,507,390 and \$ 2,582,592,116 as of June 30, 2008 and 2007, respectively. Net income produced from securities lending activities was \$ 3,303,038 and \$ 4,056,541 for fiscal years 2008 and 2007, respectively.

# 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, 2008, the System had sold forward currency contracts with a fair value of \$ 2,870,951,223 and had bought forward currency contracts with a fair value of \$ 2,870,005,069. Purchases of forward currency contracts are liabilities reported 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 exposures 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, 2008, the Retirement System had invested in TIPS with a fair value of approximately \$ 1,265,500,000.

*Custodial credit risk.* Custodial credit risk is when, in the event a financial institution or counterparty fails, the Retirement System would not be able to recover the value of deposits, investments or collateral securities that are in the possession of an outside party. One hundred percent of the Retirement System's investments are held in the System's name and are not subject to creditors of the custodial bank.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Investments (Continued)

*Concentration risk.* The Retirement System has investments in Federal National Mortgage Association issued securities that represent 5.7% of the total net asset value. The Retirement System's investment policy does not prohibit holdings above 5% in the debt securities of the U.S. government issuers. Government sponsored enterprises (GSEs, such as FNMA) are considered government issuers for the purpose of implementing Retirement System investment policy. No other single issuer represents 5% or more of System assets other than the U.S. Government.

*Currency risk.* Currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Retirement System's investments at June 30, 2008 were distributed among the following currencies:

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Investments (Continued)

Currency	USD Equivalent	Percent
Australian Dollar	\$ 181,969,386	1.16%
Brazil Real	90,681,401	0.58%
British Pound Sterling	464,942,945	2.94%
Canadian Dollar	223,224,386	1.42%
Chilean Peso	1,824,365	0.01%
Chinese Yuan Renminbi	16,394,655	0.10%
Colombian Peso	3,199,635	0.02%
Czech Koruna	7,756,815	0.05%
Danish Krone	17,564,556	0.11%
Egyptian Pound	3,924,581	0.02%
Euro Currency Unit	887,389,414	5.64%
Hong Kong Dollar	76,004,188	0.48%
Hungarian Forint	3,153,057	0.02%
Iceland Krona	2,730,990	0.02%
Indian Rupee	9,650,359	0.06%
Indonesian Rupian	14,077,718	0.09%
Israeli Shekel	7,360,533	0.05%
Japanese Yen	672,601,969	4.27%
Malaysian Ringgit	12,071,507	0.08%
Mexican New Peso	58,077,299	0.37%
Moroccan Dirham	8,552,075	0.05%
New Taiwan Dollar	43,916,170	0.28%
New Turkish Lira	21,765,426	0.14%
New Zealand Dollar	4,007,083	0.03%
Norwegian Krone	48,112,322	0.31%
Philippines Peso	1,875,050	0.01%
Polish Zloty	10,961,646	0.07%
Russian Rubel	28,122,827	0.18%
S African Comm Rand	36,815,760	0.23%
Singapore Dollar	42,871,584	0.27%
South Korean Won	88,154,148	0.56%
Swedish Krona	59,852,065	0.38%
Swiss Franc	161,513,437	1.03%
Thailand Baht	7,230,837	0.05%
Uruguayan Peso	1,434,752	0.01%
Other	1,596,722	0.01%
U.S. Dollar *	12,410,869,949	78.90%
	\$ 15,732,251,612	100.00%

\* Includes securities lending collateral of \$2,205,187,750.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Investments (Continued)

The Retirement System's asset allocation and investment policies include active and passive investments in international securities as shown on the previous page. The System's target allocation is to have 18% of assets invested in dedicated international equities (excluding securities lending collateral). The System also has 8% of assets targeted to global equities which are expected to be between 40 and 60% international. Core Plus bond managers are allowed to invest up to 20% of their portfolio in non-dollar securities. The System utilizes a currency overlay manager to reduce risk by hedging up to 50% of the foreign currency for selected international equity portfolios. At June 30, 2008, the System's total foreign currency exposure was 22.4% hedged.

*Credit risk.* Credit risk is the risk that an issuer or other counterparty to a debt investment will not fulfill its obligations. The Retirement System's investment policies require Core and Core Plus managers to have at least 70% of holdings in investment grade securities. Each portfolio is required to maintain a reasonable risk level relative to its benchmark. System assets (in thousands), as of June 30, 2008, subject to credit risk, are shown with current credit ratings below:

Quality Rating	Commercial Paper	Corporate	Agency	U.S. Government	Securities Lending Collateral	Total
NR	\$ 244,290	\$ 200,159	\$ -	\$ -	\$ 706,427	\$ 1,150,876
AAA	1,459	469,448	54,894	1,452,410	201,784	2,179,995
AA	117,724	205,661	1,204,862	80,266	1,125,480	2,733,993
A	-	381,161	-	-	165,380	546,541
BBB	-	474,932	-	-	6,117	481,049
BB	-	108,203	-	-	-	108,203
B	-	99,498	-	-	-	99,498
CCC	-	48,736	-	-	-	48,736
	<u>\$ 363,473</u>	<u>\$ 1,987,798</u>	<u>\$ 1,259,756</u>	<u>\$ 1,532,676</u>	<u>\$ 2,205,188</u>	<u>\$ 7,348,891</u>

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Investments (Continued)

Commercial paper also includes repurchase agreements and other short-term securities. Agency securities are those implicitly guaranteed by the U.S. Government. U.S. Government securities are treasury securities and agencies explicitly guaranteed. Securities Lending Collateral are securities invested using cash collateral from the securities lending program, not pooled with any other institution's funds. Securities rated A1/P1 are included in AA on the previous table. The Securities Lending Collateral class has the following policy requirements: to be rated A3/A- or better; Commercial paper must be A1/P1; Asset-backed securities must be AA3/AA- or better; Repurchase agreements must be 102% collateralized with A3/A- or A1/P1 or better securities and held by the custodial bank or third-party custodian. Securities Lending Collateral NR (Not Rated) securities are 100% repurchase agreements.

*Interest rate risk.* Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Retirement system's investment policies require Core and Core Plus managers to be within 20% of their benchmark duration, and all fixed portfolios shall maintain a reasonable risk level relative to their benchmarks. The same System assets as above are also subject to interest rate risk. These are shown below (in thousands) grouped by effective duration ranges:

Effective Duration	Commercial Paper	Corporate	Agency	U.S. Government	Securities Lending Collateral	Total
0-1 year	\$ 363,473	\$ 722,751	\$ 290,663	\$ 44,407	\$ 2,201,611	\$ 3,622,905
1-3 years	-	455,404	88,688	5,032	3,577	552,701
3-5 years	-	252,970	581,186	43,873	-	878,029
5-10 years	-	393,596	296,421	101,891	-	791,908
10-20 years	-	163,077	2,798	1,337,473	-	1,503,348
	<u>\$ 363,473</u>	<u>\$ 1,987,798</u>	<u>\$ 1,259,756</u>	<u>\$ 1,532,676</u>	<u>\$ 2,205,188</u>	<u>\$ 7,348,891</u>

Treasury Inflation Protected Securities (TIPS) comprise 97.5% of the U.S. Government 10-20 years group above. Total TIPS for all duration ranges were valued at \$ 1,303,485,245 at June 30, 2008. Securities Lending Collateral policy limits the maximum average portfolio maturity to 90 days, and only floating rate securities and fixed rate asset-backed securities may mature individually beyond 13 months.

# 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, 2008 was \$ 6,510,617. Office supplies inventory in the amount of \$ 20,753 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, 2008 was \$ 2,422,641. 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 \$ 1,397,062 and \$ 1,577,373 as of June 30, 2008 and 2007, respectively.

#### Compensated Accrued Absences

State employees accrue vacation leave based on the number of years employed up to a maximum rate of 6.5 hours per pay period and may accumulate a maximum of 240 hours. Upon retirement or termination, employees are paid for accrued vacation leave up to their maximum accumulation. State employees earn sick leave at the rate of 3.7 hours per pay period. Employees who terminate are not paid for unused sick leave. Employees who retire are paid a portion of their unused sick leave based on years of service and hours accumulated. The State uses the vesting method to compute the sick leave liability. The compensated absences liability for employees who retire will be liquidated by the State's governmental and internal service funds.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

2 - Summary of Significant Accounting Policies (Continued)

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 Retirement System reserves. 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:

**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. After ending employment and applying for withdrawal, 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, is 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 is credited at the rate of 4% per year. The balance at June 30, 2008 was \$ 4,757,361,379 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, 2008 was \$ 6,507,952,942 and the unfunded liability was \$ 5,551,799,910.

**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, 2008 was \$ 7,417,933,822 and was fully funded.

**The Expense Reserve** represents 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, 2008 was \$ 19,155,125 and was fully funded.

# KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

## NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

### 2 - Summary of Significant Accounting Policies (Continued)

#### Reserves (Continued)

**The Optional Term Life Insurance Reserve** accumulates employee contributions to pay premiums for optional life insurance coverage and is charged annually with the cost of administering the program.

#### Budget

The Retirement System's annual operating budget 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 System has an approved budget.

#### Retirement System Employees' Pension Plan

As an employer, the Retirement System participates in KPERS, a cost sharing, multi-employer defined benefit pension plan. KPERS provides retirement, disability, withdrawal and death benefits to plan members and beneficiaries as authorized by Kansas law. Funding is accomplished through member and employer contributions and investment earnings, according to Kansas law. Upon the completion of a year of service, plan members contribute 4% of their annual salary. In fiscal year 2008, the regular employer contribution rate was 6.37% of covered payroll. In addition, KPERS contributed an additional 1.0% of covered payroll to the group insurance fund. Total payroll was \$ 3,869,793, \$ 3,747,048 and \$ 3,733,163 for 2008, 2007 and 2006, respectively. KPERS contributed \$ 258,696, \$ 228,516 and \$ 212,374 for 2008, 2007 and 2006, respectively, to the employees' pension plan and group insurance fund. All contributions required by law were made in fiscal years 2008, 2007 and 2006.

#### Non-Retirement Funds

The 2000 legislative session assigned to the Retirement System the investment responsibilities of non-retirement money. 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. Legislation was also provided to defray the reasonable expenses of administering these funds. Investments under management for the Treasurer's Unclaimed Property Fund were \$ 198,923,182 at June 30, 2008.

# KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

## NOTES TO BASIC FINANCIAL STATEMENTS (Continued)

### 2 - Summary of Significant Accounting Policies (Continued)

#### New Governmental Accounting Standard

GASB Statement No. 50 *Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27* was issued in May 2007. This Statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits (OPEB) and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. The reporting changes required by this Statement amend applicable note disclosure and RSI requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform with requirements of Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement was implemented during the year ended June 30, 2008.

#### Pending Governmental Accounting Standards Board Statements

At June 30, 2008, the Governmental Accounting Standards Board had issued several statements not yet implemented by the Retirement System. The statements that might impact the System are as follows:

GASB Statement No. 51 *Accounting and Financial Reporting for Intangible Assets* was issued in June 2007. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets by enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2009.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS  
(Continued)

2 - Summary of Significant Accounting Policies (Continued)

Pending Governmental Accounting Standards Board Statements (Continued)

GASB Statement No. 53 *Accounting and Financial Reporting for Derivative Instruments* was issued in June 2008. Statement No. 53 is intended to improve how state and local governments report information about derivative instruments – financial arrangements used by governments to manage specific risks or make investments – in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009, with earlier application encouraged.

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, 2006. As a result of this study, the Board of Trustees adopted new assumptions in regard to retirement rates, mortality rates, termination rates and salary growth.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

3 - Funding Policy (Continued)

Funding (Continued)

Pension Obligation Bonds

In September 2003, the State of Kansas issued \$ 40,250,000 of Series 2003 H State pension funding bonds. Of the total amount of the bond issue, \$ 15,350,000 of the bond proceeds were used for the purpose of financing the unfunded actuarial liability of the TIAA group of members. In addition, the State of Kansas contributed an additional \$ 2,000,000 cash payment. The remaining bond proceeds of \$ 24,900,000 were used for the purpose of financing the unfunded actuarial liability of those members who retired prior to July 2, 1987, and are entitled to a Retirement Dividend payment pursuant to K.S.A. 74-49,109. Beginning in fiscal year 2005, the State's employer contribution rates for the State KPERS, School, State KPF and Judges groups included an additional amount to finance the debt service payments for this portion of the bonds. In fiscal year 2008, KPERS collected \$ 3,942,464 additional contributions for the debt service payments and transferred these funds to the State of Kansas.

In February 2004, the State of Kansas issued \$ 500 million in pension obligation bonds, and KPERS received net proceeds of \$ 440.2 million in March 2004. The proceeds have been invested to assist with financing the State and School group's unfunded actuarial liability. The debt service on the bonds will be paid by the State of Kansas in addition to the State's regular employer contributions.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

3 - Funding Policy (Continued)

Changes in Unfunded Actuarial Liability

The actuary has estimated the change in the unfunded actuarial liability between December 31, 2006 and December 31, 2007 can be attributed to the following (in millions):

Unfunded Actuarial Liability, December 31, 2006	\$	5,364
Effect of contribution cap/time lag		251
Expected increase due to amortization method		78
Gain from investment return		(626)
Demographic experience		144
All other experience		(45)
Change in actuarial assumptions		384
Change in benefit provisions		2
		<hr/>
Unfunded Actuarial Liability, December 31, 2007	\$	<u>5,552</u>

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 and Correctional members, the results of December 31, 2003 and December 31, 2004 actuarial valuations provide the basis for Board certification of employer contribution rates for fiscal years 2007 and 2008, respectively. As explained in Note 1, legislation has limited the amounts that employers are required to contribute for State, School 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 1.0% contribution rate for the Death and Disability Program for the years ended June 30, 2008 and 2007) and the statutory contribution rates for fiscal years 2007 and 2008 are as follows:

<u>Fiscal Year</u>	<u>State and School</u>		<u>Correction Employees</u>	
	<u>Actuarial Rate</u>	<u>Statutory Rate</u>	<u>Actuarial Rate</u>	<u>Statutory Rate</u>
2007	9.75%	5.77%	9.68/9.53%	7.72/7.70%
2008	10.37%	6.37%	8.90/8.84%	8.90/8.84%

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS  
(Continued)

3 - Funding Policy (Continued)

Contributions Required and Contributions Made (Continued)

Included in the fiscal year 2007 and 2008 rates is the bond debt service rate of 0.80% collected by KPERS to transfer to the State general fund for the debt service payments of the 13<sup>th</sup> Check Pension Obligation Bonds.

The results of December 31, 2004 and December 31, 2005 actuarial valuations provide the basis for Board certification of local employer contribution rates for fiscal years beginning in 2007 and 2008, respectively. The actuarially determined employer contribution rates and statutory contribution rates for fiscal years 2007 and 2008 are as follows:

<u>Fiscal Year</u>	<u>Local</u>	
	<u>Actuarial Rate</u>	<u>Statutory Rate</u>
2007	7.69%	4.31%
2008	7.92%	4.93%

KP&F - The uniform participating service rate for all KP&F employers was 13.32% for the fiscal year beginning in 2007 and 13.88% for the fiscal year beginning in 2008. 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 was 19.11% of payroll for the fiscal year ended 2007 and 22.38% of payroll for the fiscal year ended in 2008.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS  
(Continued)

3 - Funding Policy (Continued)

Contributions Required and Contributions Made (Continued)

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 required contributions have been made as follows:

	(Expressed in Thousands)		Contributions as a Percent of Covered Payroll
	Employer Contributions	Member Contributions <sup>(1)</sup>	
KPERS - State	\$ 79,477	\$ 40,853	11.2%
KPERS - School	235,139	132,613	10.4%
KPERS - Local	78,235	58,957	8.6%
KP&F	59,303	28,804	25.2%
Judges	5,998	1,481	24.3%
Subtotal	<u>\$ 458,152</u>	<u>\$ 262,708</u>	<u>10.9%</u>

(1) Member Contributions do not include Optional Life Insurance contributions of approximately \$ 7.0 million.

An estimated \$ 528 million of employer and employee contributions were made to cover normal cost, and an estimated \$ 131 million was made for the amortization of the unfunded actuarial accrued liability.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS  
(Continued)

3 - Funding Policy (Continued)

Funding Status and Funding Progress

The funding status of the plan at December 31, 2007, the most recent actuarial valuation date, is as follows (\$ 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]
12/31/2007	\$ 13,433,115	\$ 18,984,915	\$ 5,551,800	70.8%	\$ 5,949,228	93.2%

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the Actuarial Accrued Liability for benefits.

Additional information as of the latest actuarial valuation follows:

	KPERS	KP&F	Judges
Valuation date	12/31/2007	12/31/2007	12/31/2007
Actuarial cost method	Entry Age Normal	Entry Age Normal	Entry Age Normal
Amortization method	Level Percent closed	Level Percent closed	Level Percent closed
Remaining amortization period	25 years	25 years	25 years
Asset valuation method	Difference between actual return and expected return on market value of assets calculated yearly and recognized evenly over five-year period		
Actuarial assumptions:			
Investment rate of return <sup>(1)</sup>	8%	8%	8%
Projected salary increases <sup>(1)</sup>	4.0-12.0%	4.0-12.5%	4.5%
Cost of living adjustments	none	none	none

(1) Salary increases and investment rate of return include an inflation component of 3.25%.

# KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

## NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

### 3 - Funding Policy (Continued)

#### Significant Market Decreases after June 30, 2008

Negative investment returns since the December 31, 2007, valuation have had a substantial impact on the Retirement System's long-term funding outlook. Unprecedented negative returns through the fourth quarter of calendar year 2008 have been especially damaging due to the ongoing global economic crisis. The funding status of all coverage groups has been affected. Management expects the School group to be out of actuarial balance within the current amortization period, given the current actuarial assumptions and scheduled rate of contributions. Options for increasing employer contributions need to be considered to bring the System back into actuarial balance.

### 4 - Other Post Employment Benefit Plan – KPERS Death and Disability Plan

The Kansas Public Employees Retirement System administers one post employment benefit plan, KPERS Death and Disability Plan. This multiple employer, cost sharing, defined benefit plan, authorized by K.S.A. 74-4927 provides death benefits for beneficiaries for plan participants and long term disability benefits to all members in the KPERS state, school, and local coverage groups. In addition, the coverage is extended to other non KPERS members employed by the Board of Regents institutions and other state officials. The plan provides death benefits to the Judges coverage group. In order to carry out legislative intent, within the funds available, the KPERS Board of Trustees may modify plan benefits from time to time.

#### Summary of Significant Accounting Policies

*Basis of Accounting Policies.* The Retirement System's financial statements are prepared on the accrual basis in accordance with accounting principles generally accepted in the United States of America. Employer contributions are recognized as revenues when due pursuant to statutory requirements. Benefits and refunds are recognized when due and payable and expenses are recorded when the corresponding liabilities are incurred, regardless of when contributions are received or payment is made.

*Method Used to Value Investments.* Investments are reported at fair market value. Securities traded on a national or international securities exchange are valued at the last reported sales price at current exchange rates.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

4 - Other Post Employment Benefit Plan – KPERS Death and Disability Plan (Continued)

Plan Membership and Benefits

Members in the Death and Disability Plan consisted of the following at June 30, 2007, the date of the latest actuarial valuation:

Active plan members	159,186
Number of participating employers	1,391
Open claims	3,097

The Death and Disability Plan provides two primary benefits to active members, (1) group life insurance equal to 150% of annual compensation, which is provided through an insurance contract with an insurance carrier and (2) self-insured long term disability (LTD) benefits equal to 60% (66.66% before January 1, 2006) of annual compensation, offset by other benefits. Members receiving LTD benefits also receive service credit toward their retirement benefits under KPERS and have their group life insurance coverage continued under the waiver of premium provision. The group life insurance benefit is increased annually for inflation, at a rate equal to the consumer price index less 1%, beginning five years following the date of disability.

Contributions and Funded Status

Prior to fiscal year 2000, employer contributions for group life insurance and long-term disability income benefits were set by statute at 0.6 percent of covered payroll for KPERS and Board of Regents Institutions and 0.4 percent for Judges. Legislation passed in 2000 and 2001 placed a moratorium on contributions related to the group life insurance and disability benefits effective for the period 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, 2004. Legislation passed in 2005, increased the insurance contribution rate to 0.8 percent of covered payroll effective July 1, 2005, and to 1.0 percent on July 1, 2006. The rate for Judges remained at 0.4 percent. For the period ending June 30, 2008, employers contributed over \$ 62 million to the Plan.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS  
(Continued)

4 - Other Post Employment Benefit Plan – KPERS Death and Disability Plan (Continued)

Contributions and Funded Status (Continued)

The death and disability plan assets are held in the Group Insurance Reserve fund. At June 30, 2008, this reserve held net assets totaling \$ 42,460,558. This reserve is funded from deposits from employer contributions and the respective investment income. Administrative expenses for the death and disability plan are funding from the accumulated investment income of the fund. The funded status as of the most recent actuarial valuation date is as follows (\$ 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]
6/30/2007	\$ 25,568	\$ 355,729	\$ 330,161	7.2%	\$ 5,981,324	5.5%

The GASB Statement No. 43 was first effective for fiscal year ending June 30, 2007. The actuarial valuation dated June 30, 2007, is the most recent actuarial valuation using GASB 43 requirements. Only the disability benefits and waiver of premium life insurance provision are included in the actuarial valuation.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions of future employment, mortality, and long term disability trends. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress (on page 45), presents multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the long term disability benefits provided at the time of the valuation and the historical funding of the plan, which is funded exclusively by the employer. The projections of benefits for financial reporting purposes do not explicitly incorporate the potential effects of legal or contractual funding limitations on the assumption of the total costs by the employer in the future.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

4 - Other Post Employment Benefit Plan – KPERS Death and Disability Plan (Continued)

Contributions and Funded Status (Continued)

The accompanying schedule of employer contributions (on page 44) presents the amount contributed to the plan by employers in comparison to the actuarial required contribution (ARC) as determined by the actuarial valuation dated June 30, 2007, using GASB 43 requirements. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs for each year and amortize any unfunded liabilities over 15 years.

The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities consistent with the long-term perspective of the calculations. Additional information as of the latest valuation follows:

**Actuarial Valuation Information - Death and Disability Plan**

Valuation date	6/30/2007
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent, open
Remaining amortization period	15 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return <sup>(1)</sup>	4.5%
Projected salary increases <sup>(1)</sup>	4.0-9.8%
Cost of living adjustments	none

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

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

NOTES TO BASIC FINANCIAL STATEMENTS

(Continued)

5 - Commitments and Contingencies

As of June 30, 2008, the Retirement System was committed to additional funding of \$ 6,678,000 in the form of capital expenditures on separate account real estate holdings in the portfolio, \$ 197,768,000 for commitments on venture capital investments and \$ 114,626,000 for capital calls on non-core 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.

6 - Risks and Uncertainties

The System invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Subsequent to year-end, the credit and liquidity crisis in the United States and throughout the global financial system has resulted in substantial volatility in financial markets and the banking system. These and other economic events have had a significant adverse impact on investment portfolios. As of November 30, 2008, net investment losses have attributed to a \$ 3.3 billion or 25 percent decline in the fair value of the System's investments since June 30, 2008.

REQUIRED SUPPLEMENTARY INFORMATION

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM  
 SCHEDULE OF EMPLOYER CONTRIBUTIONS - RETIREMENT PLAN

Fiscal Year Ended June 30, 2008

<u>Year Ended June 30,</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
1999	\$ 230,742,037	76.7%
2000	217,757,975	77.2%
2001	249,356,715	77.6%
2002	260,482,999	79.7%
2003	282,329,785	78.9%
2004	338,879,960	69.4%
2005	381,791,085	68.6%
2006	471,424,006	63.4%
2007	531,292,151	63.9%
2008	607,662,300	65.1%

This schedule does not include Death and Disability Insurance contributions.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM  
SCHEDULE OF FUNDING PROGRESS - RETIREMENT PLAN

Fiscal Year Ended June 30, 2008

(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]
6/30/1999	\$ 8,601,876	\$ 9,999,246	\$ 1,397,370	86%	\$ 4,480,717	31%
6/30/2000	9,568,275	10,801,397	1,233,122	89%	4,684,768	26%
12/31/2000 <sup>(1)</sup>	9,835,182	11,140,014	1,304,832	88%	4,876,555	27%
12/31/2001	9,962,918	11,743,052	1,780,134	85%	5,116,384	35%
12/31/2002	9,784,862	12,613,599	2,828,737	78%	4,865,903 <sup>(2)</sup>	58%
12/31/2003	10,853,462	14,439,546 <sup>(3)</sup>	3,586,084	75%	4,978,132	72%
12/31/2004	10,971,427	15,714,093	4,742,666	70%	5,102,016	93%
12/31/2005	11,339,293	16,491,762	5,152,469	69%	5,270,351	98%
12/31/2006	12,189,197	17,552,790	5,363,593	69%	5,599,193	96%
12/31/2007	13,433,115	18,984,915	5,551,800	71%	5,949,228	93%

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

(2) Beginning with the 12/31/2002 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.

(3) Beginning with the 12/31/2003 actuarial valuation, the actuarial cost method was changed to the Entry Age Normal (EAN) method.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF EMPLOYER CONTRIBUTIONS - DEATH AND DISABILITY PLAN

Fiscal Year Ended June 30, 2008

<u>Year Ended June 30,</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
2006	\$ 71,763,879	82.6%
2007	76,128,451	82.0%

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF FUNDING PROGRESS - DEATH AND DISABILITY PLAN

Fiscal Year Ended June 30, 2008

(Dollar amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (2) (a)	Actuarial Accrued Liability (AAL) (2) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
6/30/2006 <sup>(1)</sup>	\$ 18,724	\$ 354,150	\$ 335,426	5.3%	\$ 5,716,896	5.9%
6/30/2007	25,568	335,729	330,161	7.2%	5,981,324	5.5%

(1) The June 30, 2006 actuarial valuation date was the first valuation performed using actuarial requirements as required by GASB 43.

(2) Actuarial valuation assumes insurance premiums due for the Basic Life Insurance plan are paid by current contributions. The remaining contributions, cash and investments are reserves for liabilities associated with the long term disability plan.

SUPPLEMENTARY INFORMATION

# KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

## SCHEDULE OF CONTRIBUTIONS

Fiscal Year Ended June 30, 2008

Kansas Public Employees Retirement System			
State/school contributions:			
Members	\$ 173,465,490		
Employers	<u>314,616,290</u>		
Total state/school contributions		\$ 488,081,780	
Local contributions:			
Members	58,956,726		
Employers	<u>78,234,526</u>		
Total local contributions		<u>137,191,252</u>	
Total contributions -			
Kansas Public Employees Retirement System			\$ 625,273,032
Kansas Police and Firemen's Retirement System			
State contributions:			
Members	3,138,081		
Employers	<u>6,247,201</u>		
Total state contributions		9,385,282	
Local contributions:			
Members	25,666,138		
Employers	<u>53,056,059</u>		
Total local contributions		<u>78,722,197</u>	
Total contributions -			
Kansas Police and Firemen's Retirement System			88,107,479
Kansas Retirement System for Judges			
State contributions:			
Members	1,480,720		
Employers	<u>5,998,507</u>		
Total state contributions		<u>7,479,227</u>	
Total contributions -			
Kansas Retirement System for Judges			7,479,227
Optional Life Insurance			
Member contributions:			
State employees	3,609,748		
Local employees	<u>3,286,252</u>		
Total contributions		<u>6,896,000</u>	
Total contributions -			
Optional Life Insurance			<u>6,896,000</u>
Grand total - all contributions			<u><u>\$ 727,755,738</u></u>

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF ADMINISTRATIVE EXPENSES

Fiscal Year Ended June 30, 2008

Salaries and wages		\$ 4,865,063
Professional services:		
Actuarial	\$ 281,191	
Audit	35,000	
Data processing	121,239	
Legal	47,953	
Other professional services	76,929	
	<hr/>	
Total professional services		562,312
Communication:		
Postage	225,007	
Printing	163,073	
Telephone	76,505	
	<hr/>	
Total communication		464,585
Building administration:		
Building management	72,738	
Janitorial service	47,661	
Real estate taxes	94,156	
Utilities	63,719	
	<hr/>	
Total building administration		278,274
Miscellaneous:		
Dues and subscriptions	26,053	
Repair and maintenance	744,813	
Office and equipment rent	17,767	
Supplies	88,244	
Temporary services	91,002	
Travel	166,291	
Other miscellaneous	65,961	
Depreciation	2,232,761	
	<hr/>	
Total miscellaneous		<u>3,432,892</u>
Total administrative expenses		<u>\$ 9,603,126</u>

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

Fiscal Year Ended June 30, 2008

Asset Classification	Interest, Dividends and Other Transactions	Gains and (Losses)	Total
Marketable equity securities:			
Domestic equities	\$ 54,993,404	\$ (757,006,097)	\$ (702,012,693)
International equities	79,167,357	(316,360,209)	(237,192,852)
Subtotal marketable equities	134,160,761	(1,073,366,306)	(939,205,545)
Marketable fixed income securities:			
Government	89,125,974	191,137,816	280,263,790
Corporate	94,222,748	(91,804,360)	2,418,388
Subtotal marketable fixed income	183,348,722	99,333,456	282,682,178
Temporary investments	29,347,274	(3,395,328)	25,951,946
Total marketable securities	346,856,757	(977,428,178)	(630,571,421)
Real estate	40,288,418	(75,778,668)	(35,490,250)
Alternative investments	3,822,805	40,605,297	44,428,102
Total real estate and alternative investments	44,111,223	(35,173,371)	8,937,852
Other investment income:			
Securities lending	3,303,038	-	3,303,038
Miscellaneous income	264,000	-	264,000
Total other investment income	3,567,038	-	3,567,038
Total investment income	<u>\$ 394,535,018</u>	<u>\$ (1,012,601,549)</u>	<u>(618,066,531)</u>
Manager and custodian fees and expenses:			
Investment manager fees			(29,029,817)
Custodian fees and expenses			(723,855)
Other investment expenses			(1,282,779)
Total manager and custodian fees and expenses			(31,036,451)
Net investment income			<u>\$ (649,102,982)</u>

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF INVESTMENT FEES AND EXPENSES

Fiscal Year Ended June 30, 2008

Domestic equity managers:			
Barclays Global Investors	\$	4,195,085	
Payden & Rygel Enhanced		740,508	
Quantitative Management Associates		519,922	
Subtotal domestic equity managers		<u>5,455,515</u>	\$ 5,455,515
Global equity managers:			
Capital Guardian Trust Co.		1,820,781	
Wellington Management Co.		1,419,164	
Subtotal global equity managers		<u>3,239,945</u>	3,239,945
International equity managers:			
Acadian Asset Management		2,398,821	
Alliance Capital Management		1,356,321	
Barclays Global Investors		3,231,357	
Morgan Stanley Asset Management		1,899,452	
Nomura Capital Management		828,781	
Subtotal international equity managers		<u>9,714,732</u>	9,714,732
Fixed income managers:			
Loomis, Sayles & Co.		948,084	
Pacific Investment Management Co.		1,877,982	
Payden & Rygel Investment Counsel		404,090	
Western Asset Management Co.		1,723,243	
Subtotal fixed income managers		<u>4,953,399</u>	4,953,399
Foreign currency overlay managers:			
Payden & Rygel - Overlay		104,869	
Barclays Global Investors		750,000	
Pareto Partners		1,495,640	
Subtotal foreign currency overlay managers		<u>2,350,509</u>	2,350,509
Real estate and alternative investment managers:			
AEW Capital Management		2,964,449	
Portfolio Advisors		101,250	
Subtotal real estate and alternative investment managers		<u>3,065,699</u>	3,065,699
Cash equivalent manager:			
Payden & Rygel Investment Counsel		250,018	
Subtotal cash equivalent manager		<u>250,018</u>	250,018
Total investment management fees			<u>29,029,817</u>
Other fees and expenses:			
Mellon Trust - custodian fees and expenses		729,922	
Consultant fees		1,231,765	
Legal expenses		44,947	
Subtotal other fees and expenses		<u>2,006,634</u>	2,006,634
Total investment fees and expenses	\$		<u><u>31,036,451</u></u>

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

INVESTMENT SUMMARY

(In Thousands)<sup>(1)</sup>

Fiscal Year Ended June 30, 2008

	June 30, 2007 Fair Value	Purchases and Other Increases	Sales and Other Decreases	June 30, 2008 Fair Value	Asset Mix Fair Value
<b>Marketable securities:</b>					
Domestic equities	\$ 4,615,180	\$ 1,172,680	\$ (1,846,850)	\$ 3,941,010	29.13%
International equities	3,636,725	1,473,553	(2,056,304)	3,053,974	22.58%
Total fixed income	4,546,614	10,184,758	(10,047,467)	4,683,905	34.63%
Temporary investments <sup>(2)</sup>	443,922	11,718,345	(11,672,997)	489,270	3.62%
<b>Total marketable securities</b>	<b>13,242,441</b>	<b>24,549,336</b>	<b>(25,623,618)</b>	<b>12,168,159</b>	<b>89.96%</b>
<b>Real estate and alternative investments:</b>					
Real estate	1,021,593	117,687	(183,694)	955,586	7.06%
Direct placements and limited partnerships	454,022	54,351	(105,054)	403,319	2.98%
<b>Total real estate and alternative investments</b>	<b>1,475,615</b>	<b>172,038</b>	<b>(288,748)</b>	<b>1,358,905</b>	<b>10.04%</b>
<b>Total investments</b>	<b>\$ 14,718,056</b>	<b>\$ 24,721,374</b>	<b>\$ (25,912,366)</b>	<b>\$ 13,527,064</b>	<b>100.00%</b>

(1) Amounts include changes in unrealized appreciation and exclude interest and dividend accruals. Amounts exclude security lending cash collateral of \$ 2,205,187,750 and \$ 2,418,559,400 at June 30, 2008 and 2007, 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, 2008

Fiscal Year	Benefits	Refund of Contributions		Insurance	Administration	Total
		Separations	Death			
1999	\$ 472,571,948	\$ 36,625,774	\$ 4,235,176	\$ 41,892,190	\$ 5,442,410	\$ 560,767,498
2000	505,941,764	39,390,011	4,241,839	42,199,878	5,689,571	597,463,063
2001	558,901,552	39,656,724	4,310,899	46,456,603	6,843,434	656,169,212
2002	636,398,865	33,550,967	5,515,970	47,625,764	6,776,044	729,867,610
2003	653,542,143	34,462,966	5,145,980	53,829,235	7,215,024	754,195,348
2004	685,603,796	35,903,879	5,275,591	50,396,392	7,231,295	784,410,953
2005	745,413,160	40,395,640	6,378,293	53,703,109	7,340,147	853,230,349
2006	814,789,655	40,628,580	6,197,596	54,957,957	7,718,879	924,292,667
2007	877,332,611	40,632,701	5,496,510	55,585,886	8,893,544	987,941,252
2008	954,093,592	43,197,593	5,275,097	56,718,131	9,603,126	1,068,887,539

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

CASH RECEIPTS AND DISBURSEMENTS

Fiscal Year Ended June 30, 2008

Opening cash balance		\$ 270,888
Member contributions	\$ 265,800,345	
Employer contributions	454,465,829	
System recoveries	118,972	
Refund of advancements	935,680,000	
Optional life insurance	<u>6,626,882</u>	
Total cash receipts		1,662,692,028
Withdrawal of contributions	44,128,485	
Payment to beneficiaries	14,501,225	
Retirement benefits	932,590,076	
Retirant dividend payments	13,115,659	
Group life insurance premiums	14,641,882	
Optional life insurance premiums	6,539,503	
Electronic funds transfer	32,353	
Administrative expenses	10,544,653	
Payments to LTD administrator	35,030,565	
Advanced to investment custodian	560,211,260	
Investment manager fees and expenses	<u>31,357,471</u>	
Total disbursements made		<u>1,662,693,132</u>
Ending cash balance		<u><u>\$ 269,784</u></u>



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**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**

Legislative Post Audit Committee  
Kansas State Legislature:

We have audited the financial statements of the Kansas Public Employees Retirement System, a component unit of the State of Kansas, as of and for the year ended June 30, 2008, and have issued our report thereon dated December 17, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

A control deficiency exists when the design or operation of control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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

Compliance and Other Matters

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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of 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.

*Allen, Gibbs & Houlik, L.C.*

*Berberich Trahan & Co., P.A.*

December 17, 2008



# KANSAS

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

KATHLEEN SEBELIUS, GOVERNOR

December 17, 2008

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

Dear Mr. Koehn,

Thank you for the opportunity to respond to the draft copy of your completed financial and compliance audit report. The Retirement System appreciates the professional approach taken by your firm during the engagement of 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 auditors' opinion contained in the audit.

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

Sincerely,



Glenn Deck  
Executive Director