This audit was conducted by Cochran Head Vick & Co., P.A., under contract with the Legislative Division of Post Audit. Julie Pennington was the audit manager. If you need any additional information about the audit's findings, please contact her at the Division's offices.

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reserves (Continued)
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, 2011, was $7,336,609,891. The unfunded liability was $8,264,125,185. 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, 2011, was $9,090,575,924. 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, 2011, was $19,136,754, and was fully funded. 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. The balance at June 30, 2011, was ($35,516).

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. Plan members contribute 4.0 or 6.0 percent of their annual salary. In fiscal year 2011, the regular employer contribution rate was 8.17 percent of covered payroll. In addition, KPERS contributed an additional 1.0 percent of covered payroll to the group insurance fund. Total payroll was $4,132,578, $4,190,789 and $3,915,928 for 2009, 2010 and 2011 respectively. KPERS contributed $282,130, $323,173 and $359,518 for 2009, 2010 and 2011 respectively, to the employees pension plan and group insurance fund. All contributions required by law were made in fiscal years 2009, 2010 and 2011.

Non-Retirement Fund
Legislation passed in 2000 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 administrating these funds. Investments under management for the Treasurer's Unclaimed Property Fund were $223,343,494 at June 30, 2011.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pending Governmental Accounting Standards Board Statements

The GASB exposure drafts, Financial *Reporting for Pension Plans – An amendment of GASB Statement No. 25* and *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* are the most significant changes to the way defined benefit pension assets and liabilities are reported since the original statements were issued in 1994. The objective of these proposed Statements is to improve financial reporting by state and local governmental pension plans. It is the result of a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. These proposed Statements would amend the requirements of Statements No. 25, No. 27 and No. 50, Pension Disclosures, as they relate to pension plans that are administered through trusts, or equivalent arrangements, that meet certain criteria.

The Statements are effective for financial statements prepared by state and local governments for periods beginning after June 15, 2013, with earlier application encouraged. Management is currently evaluating the effect of these statements on the Systems financial statements.

Certain amounts in the summarized comparative financial information for the prior year have been reclassified to conform to the current year presentation.

NOTE 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.

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 certain Board of Regents members. In addition, the State of Kansas contributed an additional $2.0 million cash payment.

NOTE 3: FUNDING POLICY (CONTINUED)

Pension Obligation Bonds (Continued)

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 state's employer contribution rates for the State KPERS, School, State KP&F and Judges groups included an additional amount to finance the debt service payments for this portion of the bonds. In fiscal year 2011 KPERS transferred to the State of Kansas $3,213,748 in additional contributions for the debt service payments.

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.

Changes in Unfunded Actuarial Liability

The actuary has estimated the change in the unfunded actuarial liability between December 31, 2009, and December 31, 2010, can be attributed to the following ($ in millions):

Unfunded Actuarial Liability December 31, 2009	$ 7,677.0
Effect of contribution cap/time lag	320.0
Expected increase due to amortization method	68.0
Loss from investment return	560.0
Demographic experience	(375.0)
All other experience	41.0
Change in actuarial firm/valuation software	(27.0)
Change in actuarial assumptions	—
Change in benefit provisions	—
Final Unfunded Actuarial Liability December 31, 2010	$8,264.0

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, 2006, and December 31, 2007, actuarial valuations provide the basis for Board certification of employer contribution rates for fiscal years 2010 and 2011. 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 with the actuarially determined rates.

NOTE 3: FUNDING POLICY (CONTINUED)

Contributions Required and Contributions Made (Continued)

The actuarially determined employer contribution rates (not including the 1.0 percent contribution rate for the Death and Disability Program) and the statutory contribution rates are as follows:

State/School

Fiscal Year	Actuarial Rate	Statutory Rate
2010	10.98%	7.57%
2011	11.30%	8.17%
Correctional		
2010	9.27% / 9.22%	8.04% / 7.90%
2011	9.20% / 8.64%	8.55% / 8.50%

Included in the fiscal year 2010 and 2011 rates is the bond debt service rate of 0.80 percent collected by KPERS to transfer to the State general fund for the debt service payments of the 13th Check Pension Obligation Bonds.

The results of December 31, 2007, and December 31, 2008, actuarial valuations provide the basis for Board certification of local employer contribution rates for fiscal years beginning in 2010 and 2011, respectively. The actuarially determined employer contribution rates and statutory contribution rates are as follows:

Local

Fiscal Year	Actuarial Rate	Statutory Rate
2010	8.52%	6.14%
2011	10.42%	6.74%

KP&F

The uniform participating service rate for all KP&F employers was 12.86 percent for the fiscal year beginning in 2010 and 14.57 percent for the fiscal year beginning in 2011. 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 20.50 percent of payroll for the fiscal year ended 2010 and 19.49 percent of payroll for the fiscal year ended 2011.

NOTE 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 4.0 or 6.0 percent for KPERS members, 7.0 percent for KP&F members, and 6.0 percent for Judges members as the member's employee contributions. All required contributions have been made as follows:

Employer and Employee Contributions
(in thousands)

	Employer and Insurance Contributions	Member Contributions (1)	Contributions as a Percent of Covered Payroll
KPERS- State	$ 97,759	$ 45,709	12.0 %
KPERS- School	292,772	139,914	12.1
KPERS - Local	116,348	69,721	10.3
KP&F	62,356	30,786	21.8
Judges	5,402	1,471	24.8
Subtotal	**$ 574,637**	**$ 287,601**	**12.2 %**

(1) Member contributions do not include Optional Life Insurance contributions of approximately $6.7 million.

An estimated $603 million of employer & employee contributions were made to cover normal cost, an estimated $259 million was made for the amortization of the unfunded actuarial accrued liability.

Funding Status and Funding Progress

The funding status of the plan at December 31, 2010, the most recent actuarial valuation date:

(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)
12/31/10	$13,589,658	$21,853,783	$8,264,125	62%	$6,494,048	127%

NOTE 3: FUNDING POLICY (CONTINUED)

Funding Status and Funding Progress (Continued)

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	12/31/2010	12/31/2010	12/31/2010
Actuarial cost method	Entry Age Normal	Entry Age Normal	Entry Age Normal
Amortization method	Level Percent closed	Level Percent closed	Level Dollar closed
Remaining amortization period	22 years	22 years	22 years
Asset valuation method	Difference between actual return and expected return on market value recognized evenly over five-year period. Value must be within corridor of 80 percent to 120 percent of market value.		
Actuarial assumptions:			
Investment rate of return (1)	8%	8%	8%
Projected salary increases (1)	4.0% - 12.0%	4.0% - 12.5%	4.5%
Cost of Living Adjustment	none	none	none

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

NOTE 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 of 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 at 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.