FINANCIAL AUDIT REPORT

Kansas Public Employees Retirement System: Fiscal Year 2012

A Report to the Legislative Post Audit Committee
By Cochran Head Vick & Co., P.A., Under Contract with
the Legislative Division of Post Audit
State of Kansas
December 2012

R-12-014

Legislative Post Audit Committee

Legislative Division of Post Audit

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about $14 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 ten members, the two majority caucuses each have three members, while the two minority caucuses each have two members.

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LEGISLATIVE DIVISION OF POST AUDIT

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Scott Frank, Legislative Post Auditor

HOW DO I GET AN AUDIT APPROVED?

By law, individual legislators, legislative committees, or the Governor may request an audit, but any audit work conducted by the division must be directed by the Legislative Post Audit Committee, the 10-member joint committee that oversees the Division's work. Any legislator who would like to request an audit should contact the division directly at (785) 296-3792.

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LEGISLATURE OF KANSAS

LEGISLATIVE DIVISION OF POST AUDIT

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December 6, 2012

To: Members, Legislative Post Audit Committee

Senator Mary Pilcher-Cook, Chair
Senator Terry Bruce
Senator Anthony Hensley
Senator Laura Kelly
Senator Dwayne Umbarger

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

This report contains the findings and conclusions from the completed financial audit of the Kansas Public Employees Retirement System for Fiscal Year 2012. Cochran Head Vick & Co., P.A., a certified public accounting firm under contract with the Legislative Division of Post Audit, conducted this audit. We would be happy to discuss the findings or any other items presented in this report with any legislative committees, individual legislators, or other State officials.

Sincerely,

Scott Frank
Legislative Post Auditor

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 Julie at the Division's offices.

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KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

FINANCIAL AND COMPLIANCE AUDIT REPORT

YEAR ENDED JUNE 30, 2012

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

FINANCIAL AND COMPLIANCE AUDIT REPORT

Year Ended June 30, 2012

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Introduction

The Kansas Public Employees Retirement System (the System or KPERS) provides a systematic retirement plan, as well as a 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 contract 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, 2012

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

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COCHRAN HEAD VICK & CO., P.A.

Certified Public Accountants

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Independent Auditors' Report

Legislative Post Audit Committee
Kansas State Legislature:

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, 2012, 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 summarized comparative financial information has been derived from the System's 2011 financial statements and, in our report dated October 17, 2011 we expressed an unqualified opinion on the respective 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, 2012, 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 October 15, 2012 on our consideration of the System's internal control over financial reporting and on our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope or 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.

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Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 5 through 10 and the required supplementary information on pages 40 through 43 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The supplementary information 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.

October 15, 2012 Cochran Head Vick & Co., P.C

MANAGEMENT'S DISCUSSION & ANALYSIS

This section presents management's discussion and analysis of the Kansas Public Employees Retirement System's financial performance during the fiscal year that ended June 30, 2012. It is presented as a narrative overview and analysis in conjunction with the Executive Director's letter of transmittal.

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 (KPERS)
- Kansas Police and Firemen's Retirement System (KP&F)
- Kansas Retirement System for Judges (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. Participation by local political subdivisions is optional but irrevocable once elected.

Financial Highlights

- The System's net assets decreased by $363 million or 2.7% percent from $13.47 billion to $13.1 billion.

- As of December 31, 2011, the date of the most recent actuarial valuation, the Retirement System's funded ratio was 59.2 percent compared with a funded ratio of 62.2 percent for the prior year.

- The unfunded actuarial liability increased from $8.3 billion at December 31, 2010, to $9.2 billion at December 31, 2011.

- On a market value basis, this year's investment rate of return was a positive 1.0 percent, compared with last year's return of a positive 22.6 percent.

- Retirement benefits paid to retirees and beneficiaries increased 7.9 percent from $1.15 billion in fiscal year 2011 to $1.24 billion in fiscal year 2012.

Overview of the Financial Statements

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

- Basic financial statements
- Notes to the basic financial statements
- Required supplementary information
- Other supplementary schedules

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, 2012, and a Statement of Changes in Plan Net Assets for the fiscal year ended June 30, 2012, 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 in the paragraphs that follow.

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, which was effective for periods beginning after December 15, 2005. The KPERS Death and Disability Plan covers current active members of the System and terminates at retirement. 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 4.5 percent funded as of June 30, 2010, 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.

Note 6 provides the dates through which subsequent events have been evaluated and when the financial statements were available to be issued.

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 post employment benefits.

Other Supplementary Schedules

Other schedules include detailed information on contributions by employer coverage groups, administrative expenses, an investment income summary, and a schedule of investment fees and expenses.

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, 2012, amounted to $13.1 billion, a decrease of $363 million, 2.7 percent, from $13.5 billion at June 30, 2011. Following are two summary schedules, Plan Net Assets and Changes in Plan Net Assets, comparing information from fiscal years 2012 and 2011.

Summary Comparative Statements of Plan Net Assets

	As of June 30, 2012	As of June 30, 2011
Assets		
Cash and Deposits	$ 10,899,775	$ 3,207,179
Receivables	2,048,504,812	3,402,041,265
Investments at Fair Value	13,277,146,799	13,236,304,711
Invested Securities Lending Collateral	1,051,425,908	960,689,299
Capital Assets and Supplies Inventory	2,645,766	3,604,285
Total Assets	16,390,623,060	17,605,846,739
Liabilities		
Administrative Costs	975,198	564,023
Benefits Payable	7,036,167	2,068,925
Investments Purchased	2,202,250,732	3,145,691,588
Securities Lending Collateral	1,074,549,112	988,669,397
Total Liabilities	3,284,811,209	4,136,993,933
Net Assets	$ 13,105,811,851	$ 13,468,852,806

Summary Comparative Statements of Changes in Plan Net Assets

	Year Ended June 30, 2012	Year Ended June 30, 2011
Additions		
Contributions	$ 915,741,287	$ 868,951,933
Net Investment Income	84,238,967	2,494,339,663
Net Investment Income from Securities Lending Activity	4,817,667	5,150,948
Total Net Investment Income	89,056,634	2,499,490,611
Other Miscellaneous Income	202,558	190,770
Total Additions	1,005,000,479	3,368,633,314
Deductions		
Monthly Retirement Benefits	1,237,559,898	1,147,209,272
Refunds	55,896,826	49,564,015
Death Benefits	9,414,234	9,614,688
Insurance Premiums and Disability Benefits	55,169,430	53,505,311
Administrative	10,001,046	9,624,617
Total Deductions	1,368,041,434	1,269,517,903
Net Increase (Decrease)	(363,040,955)	2,099,115,411
Net Assets Beginning of Year	$ 13,468,852,806	$ 11,369,737,395
Net Assets End of Year	**$ 13,105,811,851**	**$ 13,468,852,806**

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 $869 million in fiscal year 2011 to $916 million in fiscal year 2012.

The System recognized a net investment income of $89.1 million for the 2012 fiscal year, compared with net income of $2.5 billion for the 2011 fiscal year. Total return for the portfolio was 1.0 percent, compared with the benchmark return of 2.1 percent. System net investments amounted to $13.0 billion at June 30, 2012 which was $0.3 billion less than the $13.3 billion in total System investments at June 30, 2011. The Retirement System's one-, three-, five- and ten-year investment performance against the assumed rate of investment return are shown in the following table. The assumed rate of return is 8.0 percent.

One Year	Last Three Years	Last Five Years	Last Ten Years
1.0%	12.5%	1.8%	6.9%

At June 30, 2012, the System held $7.7 billion in U.S. equity and international equity securities, which is unchanged from the 2011 fiscal year. U.S. equity and international equity securities earned returns of approximately 4.1 percent and negative 11.2 percent, respectively, for the 2012 fiscal year. These compare with the Retirement System's benchmark returns of 3.8 and negative 14.6 percent, respectively.

The System held $3.7 billion in U.S. debt and international debt securities, compared to $3.8 billion in 2011 fiscal year. The performance of the System's fixed income securities during fiscal year 2012 was 6.4 percent, compared with the benchmark of 7.4 percent. Real estate investments increased $254.1 million to $1.3 billion at June 30, 2012. Real estate investments returned approximately 8.5 percent for the 2012 fiscal year, versus the benchmark real estate return of 14.0 percent. The System held $387.2 million in alternative investments, which was a $17.8 million increase from June 30, 2011. Alternative investments earned a return of approximately 3.6 percent for the 2012 fiscal year, compared to the benchmark alternative investment return of 6.8 percent. At June 30, 2012, the System held $205.4 million in short-term investments, which was a decrease of $160.2 million from June 30, 2011.

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 2012, net securities lending income amounted to $4.8 million, compared with income of $5.2 million in fiscal year 2011.

Deductions from net assets held in trust for benefits include retirement, death and survivor benefits, and administrative expenses. For the 2012 fiscal year, retirement, death and insurance benefits amounted to $1,358 million, an increase of $98.1 million, 7.8 percent, from the 2011 fiscal year. The increase in benefit payments was a result of an increase in the number of retirees. For the 2012 fiscal year, System administrative expenses amounted to $10.0 million compared with $9.6 million in fiscal year 2011. The ratio of System administrative expenses to the number of members (approximately $42 per member) continues to be very cost-efficient compared to other statewide retirement plans.

Retirement Funding Status

Current Funding Outlook and Projections

The Retirement System's most recent actuarial valuation shows a $964 million increase in the unfunded actuarial liability (UAL), decreasing the funded ratio to 59 percent.

	UAL (millions)	Funded Ratio
KPERS		
State Group	$ 1,123	71%
School Group	5,798	52%
Local Group	1,542	61%
KP&F	739	70%
Judges	27	83%
Retirement System Total*	**$ 9,228**	**59%**

*May not add due to rounding

As of the latest valuation date, December 31, 2011, the State group continues to contribute at the full actuarial required contribution (ARC) rate. The State and School groups are combined for purposes of determining the statutory contribution rate applicable to their combined payroll. To the extent the statutory contribution rate is higher than the ARC for the State, the difference, applied to the State payroll, is contributed to the School group. Consequently, the two groups are linked for purposes of determining the ARC date and rate. Furthermore, legislation passed in 2012 provided for additional contributions by the State commencing in fiscal year 2014 and continuing until the combined State/School group is at least 80% funded. The statutory contribution rate for the State/School and Local groups is projected to converge with the ARC rate before the end of the amortization period (2033), if all actuarial assumptions are met in future years. The ARC Date for the State/School group is FY 2021 and for the Local group is FY 2017. Although ARC is projected to be achieved if actuarial assumptions are met, the dates and rates of ARC for these groups are highly leveraged and will vary as experience unfolds year to year.

In spite of the funding shortfall, benefits for current retirees are safe. The Retirement System has approximately $13 billion in assets to pay benefits for decades.

In response to KPERS' long-term funding shortfall, the 2012 Legislature made changes to future benefits and contributions, affecting both current members and employers, to improve KPERS long term sustainability. The Governor signed Senate Substitute for HB 2333 into law on June 1, 2012. This legislation affects new hires, current members and employers. Beginning in 2014, the cap on employer contributions has been increased from 0.60% to, 0.9% in fiscal year 2014, 1.0% in fiscal year 2015, 1.1% in fiscal year 2016 and 1.2% in fiscal year 2017 and beyond. Members (depending on tier and a possible option election), will have a contribution increase or a benefit decrease. The changes are expected to improve KPERS long term funding and help all three groups reach full funding by 2033. The actual funding progress will be heavily dependent on the actual investment experience of the System in future years.

The legislature and the governor are ultimately responsible for benefits and funding. As a fiduciary devoted to the best financial interest of members, KPERS will continue to advocate for policies that promote the long-term financial health of the Retirement System.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

STATEMENT OF PLAN NET ASSETS

June 30, 2012
With Comparative Totals for June 30, 2011

	KPERS Fund	Group Death & Disability Fund	2012 Totals	2011 Totals
Assets				
Cash and Deposits				
Cash	$ 10,104,931	$ 794,844	$ 10,899,775	$ 3,207,179
Total Cash and Deposits	10,104,931	794,844	10,899,775	3,207,179
Receivables				
Contributions	88,779,493	9,384,103	98,163,596	154,799,437
Investment Income	34,403,329	1,065	34,404,394	37,387,163
Sale of Investment Securities	1,915,936,822	-	1,915,936,822	3,209,854,665
Total Receivables	2,039,119,644	9,385,168	2,048,504,812	3,402,041,265
Investments at Fair Value				
Domestic Equities	4,500,360,801	-	4,500,360,801	3,786,594,006
International Equities	3,182,774,490	-	3,182,774,490	3,871,748,944
Cash and Equivalents	193,165,823	12,283,865	205,449,688	365,568,474
Fixed Income	3,705,502,848	-	3,705,502,848	3,801,271,106
Alternative Investments	387,198,726	-	387,198,726	369,393,242
Real Estate	1,295,860,246	-	1,295,860,246	1,041,728,939
Total Investments at Fair Value	13,264,862,934	12,283,865	13,277,146,799	13,236,304,711
Invested Securities Lending Collateral	1,051,425,908	-	1,051,425,908	960,689,299
Capital Assets and Supplies Inventory	2,638,566	7,200	2,645,766	3,604,285
Total Assets	**16,368,151,983**	**22,471,077**	**16,390,623,060**	**17,605,846,739**
Liabilities				
Administrative Costs	975,198	-	975,198	564,023
Benefits Payable	3,633,556	3,402,611	7,036,167	2,068,925
Securities Purchased	2,202,250,732	-	2,202,250,732	3,145,691,588
Securities Lending Collateral	1,074,549,112	-	1,074,549,112	988,669,397
Total Liabilities	**3,281,408,598**	**3,402,611**	**3,284,811,209**	**4,136,993,933**
Net Assets held in trust for Pension Benefits and Other Post Employment Benefits	**$ 13,086,743,385**	**$ 19,068,466**	**$ 13,105,811,851**	**$ 13,468,852,806**

(Schedules of Funding Progress are presented on pages 41 and 43)

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

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

STATEMENT OF CHANGES IN PLAN NET ASSETS

Fiscal Year Ended June 30, 2012
With Comparative Totals for Fiscal Year Ended June 30, 2011

	KPERS Fund	Group Death & Disability Fund	2012 Totals	2011 Totals
Additions				
Contributions				
Member Contributions	$ 298,105,053	$ -	$ 298,105,053	$ 294,314,002
Employer Contributions	568,015,364	49,620,870	617,636,234	574,637,931
Total Contributions	866,120,417	49,620,870	915,741,287	868,951,933
Investments				
Net Appreciation (Depreciation) in Fair Value of Investments	(132,729,256)	-	(132,729,256)	2,211,302,374
Interest	103,584,321	10,852	103,595,173	158,139,067
Dividends	110,902,858	-	110,902,858	123,098,602
Real Estate Income, Net of Operating Expenses	44,259,544	-	44,259,544	48,997,734
Other Investment Income	436,311	-	436,311	388,174
	126,453,778	10,852	126,464,630	2,541,925,951
Less Investment Expense	(42,225,663)	-	(42,225,663)	(47,586,288)
Net Investment Income	84,228,115	10,852	84,238,967	2,494,339,663
From Securities Lending Activities				
Securities Lending Income	4,353,102	-	4,353,102	5,431,118
Other Securities Lending Activities				
Borrower Rebates	1,769,773	-	1,769,773	739,912
Management Fees	(1,305,208)	-	(1,305,208)	(1,020,082)
Total Other Securities Lending Activities	464,565		464,565	(280,170)
Net Income from Security Lending Activities	4,817,667	-	4,817,667	5,150,948
Total Net Investment Income	89,045,782	10,852	89,056,634	2,499,490,611
Other Miscellaneous Income	200,644	1,914	202,558	190,770
Total Additions	955,366,843	49,633,636	1,005,000,479	3,368,633,314
Deductions				
Monthly Retirement Benefits Paid	(1,237,559,898)	-	(1,237,559,898)	(1,147,209,272)
Refunds of Contributions	(55,896,826)	-	(55,896,826)	(49,564,015)
Death Benefits	(9,414,234)	-	(9,414,234)	(9,614,688)
Insurance Premiums and Disability Benefits	(6,128,984)	(49,040,446)	(55,169,430)	(53,505,311)
Administrative Expenses	(9,693,869)	(307,177)	(10,001,046)	(9,624,617)
Total Deductions	(1,318,693,811)	(49,347,623)	(1,368,041,434)	(1,269,517,903)
Net Increase (Decrease)	(363,326,968)	286,013	(363,040,955)	2,099,115,411
Net Assets held in trust for Pension Benefits and Other Post Employment Benefits				
Balance Beginning of Year	13,450,070,353	18,782,453	13,468,852,806	11,369,737,395
Balance End of Year	$ 13,086,743,385	$ 19,068,466	$ 13,105,811,851	$ 13,468,852,806

The accompanying notes to the basic financial statements are an integral part of this statement.

NOTE 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:

- Kansas Public Employees Retirement System (KPERS)
- Kansas Police and Firemen's Retirement System (KP&F)
- 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 and 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 membership and employers are as follows:

Membership by Retirement Systems (1)

	KPERS	KP&F	Judges	Total
Retirees and beneficiaries currently receiving benefits (2)	76,464	4,346	215	81,025
Terminated employees entitled to benefits but not yet receiving them	14,605	199	7	14,811
Inactive members, deferred disabled	2,711	197	0	2,908
Inactive members not entitled to benefits	26,950	1,009	0	27,959
Current employees	147,647	7,143	264	155,054
Total	268,377	12,894	486	281,757

(1) Represents System membership at December 31, 2011.
(2) Number of retirement payees as of December 31, 2011.

NOTE 1: PLAN DESCRIPTION (CONTINUED)

Plan Membership (Continued)

Number of Participating Employers

	KPERS	KP&F	Judges
State of Kansas	1	1	1
Counties	105	31	—
Cities	362	61	—
Townships	56	—	—
School Districts	286	—	—
Libraries	122	—	—
Conservation Districts	84	—	—
Extension Councils	73	—	—
Community Colleges	19	—	—
Educational Cooperatives	23	—	—
Recreation Commissions	43	1	—
Hospitals	29	—	—
Cemetery Districts	12	—	—
Other	194	—	—
Total	1,409	94	1

Plan Benefits

Members (except KP&F members) with ten 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 ten 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.

Members choose one of seven payment options for their monthly retirement benefits. At retirement a member may receive a lump-sum payment of up to 50 percent of the actuarial present value of the member’s lifetime benefit. His or her monthly retirement benefit is then permanently reduced 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.

NOTE 1: PLAN DESCRIPTION (CONTINUED)

Plan Benefits (Continued)

Active members (except KP&F members) are covered by basic group life insurance. The life insurance benefit is 150 percent 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 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) when a retired member dies under any of the 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 percent 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.

Contributions

Member contributions (from 4.0 to 7.0 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, Kansas legislation placed a statutory limit of 0.1 percent of payroll on increases in contribution rates for KPERS employers. During the 1995 legislative session, the statutory limits were increased to 0.2 percent 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 percent 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 percent in fiscal year 2006, with subsequent increases of 0.5 percent in fiscal year 2007 and 0.6 percent 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 percent in calendar year 2006, with subsequent increases of 0.5 percent in fiscal year 2007 and 0.6 percent in fiscal year 2008 and beyond. Legislation passed in 2012 again amended the statutory cap on annual increases in contribution rates. Beginning in 2014, the cap on employer contributions has been increased to 0.9% in fiscal year 2014, 1.0% in fiscal year 2015, 1.1% in fiscal year 2016 and 1.2% in fiscal year 2017 and beyond. The amortization period for the unfunded liability of all three systems is 40 years from July 1, 1993.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The 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.

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 resource 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 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, 2011, from which the summarized information was derived.

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, 2012, the Retirement System's deposit with its disability administrator was $-0-. The Retirement System does not have a deposit policy for custodial credit risk associated with these deposits.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Method Used to Value Investments

Investments are reported at fair value. Securities traded on a national or international securities exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate investments is based on independent appraisals. Fair value of other securities is determined by the mean 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 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, imposing the prudent expert standard upon their 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 60.0 percent of the total book value of the fund.
- The annual allowance for new alternative (non-publicly traded) investments is limited to 1.0 percent 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.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments (Continued)

- Provides for an annual audit and requires that the Board annually examine the investment program, specific investments, and its policies and practices.

In fulfilling its responsibilities, the Board of Trustees has contracted with 28 investment management firms and a master global custodian. The Retirement System has six permissible investment categories. 1) Equities 2) Real estate 3) Fixed income securities 4) Derivative products 5) Cash equivalents 6) Alternative investments.

Equities are considered to be common or preferred corporate stocks; warrants or rights; corporate bonds, debentures or preferred stock which are convertible into common stock; investment trusts; or participation in commingled (equity) funds managed by a bank, insurance company or other professional equity investment manager. These stocks are listed on well recognized or principal exchanges of the United States or foreign countries.

Fixed income securities are considered to be U.S. and foreign Treasury or Government agency obligations; U.S. or foreign corporate bonds; asset backed securities such as CMOs, mortgage backed securities and segments of these types of vehicles; or participation in commingled (fixed income) funds, managed by a bank, insurance company or other professional fixed income investment manager. Subject to the Board's limitations, these investments also include the debt of emerging markets. Emerging markets are considered to be those countries that are included in the JP Morgan Emerging Markets Index Global (EMBI Global).

Cash equivalent securities are U.S. dollar denominated securities with a duration of one year or less and an investment grade rating by Moody's and Standard & Poor's. A security's duration is determined by a third-party pricing agency.

Derivative instruments are tools for use by the System's investment managers for the purposes of:

- Risk Management: Mitigating or managing portfolio risks through hedging or otherwise modifying specific risk exposure.
- Substitution: In substitution for "cash market" securities/positions, or for modifying portfolio positioning in lieu of cash market transactions.
- Derivative-based Strategies: As a structural part of an investment strategy.
- Efficiency/Cost Effectiveness: Efficiency and/or cost effectiveness in implementing: portfolio construction, trading, portfolio strategy or managing a portfolio's risk/return profile.

Alternative investments are those investments that do not trade publicly on an organized exchange. Examples include but are not limited to partnership funds that focus on private equity, venture capital, buyout, mezzanine financing or special situations, natural resources or hedge funds. Prospective investment in any alternative investments are subject to the following requirements:

- There are at least two other sophisticated investors.
- The System's portion of an investment will not be more than 20 percent of the total investment.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments (Continued)

- Any individual investment (standing alone or within a pool) must not be more than 2.5 percent of the Fund's total alternative investment commitments.
- A favorable recommendation has been received from an independent expert.
- The investment is consistent with the Investment Policy Statement.
- The Board has received and considered the due diligence findings regarding the investment.
- Criteria have been established that will be used as a guideline to determine when no additional investments will be made and when the investment will be liquidated.

Real estate investments are investments in real property on a direct ownership basis, through a realty holding corporation, joint partnership, public or private real estate investment trusts (REITs) (contained within the real estate portfolio), participation in commingled real estate funds (managed by a bank, insurance company or other professional real estate investment manager) or through debt secured by real estate. Any real estate investment shall support the System's intent to hold a real estate portfolio which is diversified by geographic location, property type, stage of development and degree of leverage.

The Retirement System's Statement of Investment Policy authorizes participation in a securities lending program administered by the master global custodian, Bank of New York Mellon. The System receives income from the loan of the securities, in addition to the income which accrues to the System as owner of the securities. The securities loans are open contracts and therefore could be terminated at any time by either party. The type of securities lent includes 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 102.0 percent of fair value on domestic securities and 105.0 percent of fair value on international securities loaned. Cash collateral is invested in the Retirement System's name in a dedicated short-term investment fund consisting of investment grade debt securities. The System does not have the ability to pledge or sell collateral securities without a borrower default. At June 30, 2012, the maturities of securities in this dedicated bond portfolio are as follows: 35.1 percent of the fair value of the securities mature within 30 days; 34.2 percent mature between 31 and 180 days; and 30.7 percent 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. The Retirement System does incur credit risk as it relates to the credit quality of the securities in the collateral pool. The securities on loan are marked to market daily to ensure the adequacy of the collateral. The fair value of securities on loan as of June 30, 2012, and June 30, 2011, were $1,673,130,416 and $1,215,075,532, respectively. Collateral held by the Retirement System for June 30, 2012, and June 30, 2011, was $1,750,761,499 and $1,271,582,150, respectively. Net income produced from securities lending activities for fiscal year 2012 was $4,817,667, with $5,150,948 for fiscal year 2011.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Currency Risk

Currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. KPERS investments at June 30, 2012, were distributed among currencies in the following list.

USD Equivalent	Currency	Percent
$ 151,166,578	Australian Dollar	1.14%
56,112,356	Brazilian Real	0.42%
641,080,107	British Pound	4.83%
224,919,901	Canadian Dollar	1.70%
4,620,447	Chilean Peso	0.03%
64,847,685	Chinese Yuan Renminbi	0.49%
3,047,529	Colombian Peso	0.02%
31,346,907	Danish Krone	0.24%
702,885,372	Euro Currency Unit	5.30%
130,381,322	Hong Kong Dollar	0.98%
20,300,148	Indian Rupee	0.15%
13,906,434	Indonesian Rupian	0.10%
8,360,378	Israeli Shekel	0.06%
420,980,569	Japanese Yen	3.17%
16,062,761	Malaysian Ringgit	0.12%
69,234,078	Mexican New Peso	0.52%
4,798,882	New Zealand Dollar	0.04%
36,730,026	Norwegian Krone	0.28%
6,432,954	Other	0.05%
1,572,918	Peru Nuevo Sol	0.01%
9,671,280	Philippines Peso	0.07%
5,098,482	Polish Zloty	0.04%
20,342,485	Russian Rubel	0.15%
53,741,762	South African Rand	0.41%
52,569,837	Singapore Dollar	0.40%
94,497,592	South Korean Won	0.71%
94,801,955	Swedish Krona	0.71%
156,156,219	Swiss Franc	1.18%
60,689,028	Taiwan New Dollar	0.46%
12,175,683	Thailand Baht	0.09%
15,344,978	Turkish New Lira	0.13%
11,132,412,189	United States Dollar *	76.00%
14,316,288,842		100.00%

* Includes securities lending collateral of $1,051,425,908
Of the $3.2 million in foreign currency exposure above, $0.15million (4.7%) is from fixed securities. The balance is in equities.

The System's asset allocation and investment policies include active and passive investments in international securities. KPERS' target allocation is to have 29.0 percent of assets (excluding securities lending collateral) in dedicated international equities. Core Plus bond managers are allowed to invest up to 20.0 percent of their portfolio in non-dollar securities. The System utilizes a currency overlay manager to reduce risk by hedging up to 50 percent of the foreign currency for selected international equity portfolios. At June 30, 2012, the System's total foreign currency exposure was 18.8 percent hedged.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 value of deposits, investments or collateral securities that are in the possession of an outside party. One hundred percent (100 percent) of the Systems investments are held in the System's name and are not subject to creditors of the custodial bank.

Concentration Risk

The System has investments in Federal National Mortgage Association issued securities that represent 3.8 percent of the total market value, other agencies sum to 2.6 percent of market value, and U.S. Treasury securities representing 8.5 percent of total market value. KPERS investment policy does not prohibit holdings above 5 percent in the debt securities of U.S. government issuers. Government sponsored enterprises (GSEs, such as FNMA) are considered government issuers for the purpose of implementing KPERS investment policy. No other single issuer represents 1 percent or more of System assets.

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 70.0 percent of holdings in investment grade securities. Each portfolio is required to maintain a reasonable risk level relative to its benchmark.

In the table below, cash equivalents includes commercial paper, 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 in this table. The Securities Lending Collateral class has the following policy requirements, at the date of purchase: to be rated A1/A+ or better; Commercial paper must be A1/P1/F1; Asset-backed securities must be Aaa/AAA or better; Repurchase agreements must be 102 percent collateralized with U.S. government or agency securities and held by the custodial bank or third-party custodian. Securities Lending Collateral NR (Not Rated) securities are repurchase agreements and certificates of deposit.

System assets (in thousands) as of June 30, 2012, subject to credit risk are shown with current credit ratings.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Credit Risk (Continued)

Quality Rating	Cash Equivalents	Corporate	Agency	U.S. Govt	Securities Lending Collateral	Total
NR	$ 16,489	$ 199,488	$ -	$ -	$ 235,892	$ 451,869
AAA	-	79,924	-	-	44,418	124,342
AA	5,682	252,255	881,562	1,261,680	540,295	2,941,474
A	-	278,678	-	-	230,822	509,500
BBB	-	465,549	-	-	-	465,549
BB	-	249,189	-	-	-	249,189
B	-	155,522	-	-	-	155,522
CCC	-	34,954	-	-	-	34,954
CC	-	2,397	-	-	-	2,397
C	-	7,831	-	-	-	7,831
D	-	2,174	-	-	-	2,174
Total	$ 22,171	$ 1,727,962	$ 881,562	$ 1,261,680	$ 1,051,426	$ 4,944,800

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investment policy requires Core and Core+ managers to be within 20.0 percent 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 in the following ($ in thousands) grouped by effective duration ranges.

Effective Duration	Commercial Paper	Corporate	Agency	U.S. Govt	Securities Lending Collateral	Total
0 - 1 yr	$ 22,171	$ 526,097	$ 298,002	$ 133,534	$ 993,919	$ 1,973,723
1 - 3 yrs	-	165,783	501,458	866,499	57,507	1,591,247
3 - 5 yrs	-	371,083	72,479	81,897	-	525,459
5 - 10 yrs	-	474,266	8,055	126,648	-	608,969
10 - 20 yrs	-	190,733	1,568	53,101	-	245,402
Total	$ 22,171	$ 1,727,962	$ 881,562	$ 1,261,679	$ 1,051,426	$ 4,944,800

Securities Lending Collateral policy limits the maximum average portfolio maturity of 90 days and only floating rate, and fixed rate asset-backed, securities may mature beyond 13 months.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment Derivatives (Continued)

Investment Derivatives—Futures

Futures contracts are commitments for delayed delivery (liability) or receipt (asset) 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. 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. Daily, the net change in the futures contract value is settled in cash with the exchanges, making the fair values always equal to zero after the daily margin flow. At the close of business June 30, 2012 the System had total net margins payable the next day of $3,926,142. 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 daily margin flows effect cash assets held at broker. Realized gains/losses are recognized at contract maturity and included with underlying security type returns. Total revenues of $56.9 million were associated with futures for the year ending June 30, 2012.

Investment Derivatives—Options

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. The option buyer has some counterparty risk in the event the seller cannot deliver when exercised. This involves opportunity cost and possible loss of option fees. The option seller holds the securities and has minimal counterparty risk. Options strategies used by the Retirement System are designed to provide exposures to positive market moves and limit exposures to interest rate and currency volatility.

Investment Derivative Notional Values

	Asset Class *	June 30, 2011	June 30, 2012
Domestic Equity Futures	Domestic Equities	$ 1,196,118,375	$ 135,844,640
International Equity Futures	International Equities	739,787,477	103,933,505
Fixed Futures	Fixed	997,215,207	121,032,212
Options Written	Fixed	936,376	214,363
Pay Fixed Interest Swaps	Fixed	20,550,000	20,400,000
Receive Fixed Interest Swaps	Fixed	154,000,000	154,000,000
Credit Default Swaps	Fixed	441,320,845	100,975,893
TBA Agency Bonds **	Fixed	(112,261,173)	212,499,050

* The Asset Class that the Fair Values and Revenues are included in other schedules. Futures and Options reflect the summed absolute values of the exposures.

**TBA Agency Bond notional values are equal to their fair values. KPERS investment policy allows managers to carry short TBA values as long as there are offsetting long holdings in similar securities with similar characteristics.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment Derivatives (Continued)

Investment Derivatives—Swaps

Interest rate swaps are agreements between two counterparties to exchange future cash flows. These are generally fixed vs. variable flows, and can be either received or paid. These swaps are used to adjust interest rate and yield curve exposure and substitute for physical securities. Long swap positions (receive fixed) increase exposure to long-term interest rates; short positions (pay fixed) decrease exposure. Counterparty risk is limited to monthly exchanged or netted cash flows.

Credit default swaps are used to manage credit exposure without direct purchase or sale of securities. Written credit default swaps increase credit exposure (selling protection) obligating the seller to buy the bonds from the counterparty in the event of a default. This creates credit risk, but has very little counterparty risk. Purchased credit default swaps decrease exposure (buying protection), providing the right to “put” bonds to the counterparty in the event of a default. This decreases credit risk, and has counterparty risk in the event the seller of protection fails to cover the defaulting security. Controls are established by the investment managers to monitor the creditworthiness of the counterparties.

Investment Derivatives—TBA (To Be Announced) Agency Bonds

A TBA is a contract for the purchase or sale of agency mortgage-backed securities to be delivered at a future agreed-upon date; however, the actual pool identities or the number of pools that will be delivered to fulfill the trade obligation or terms of the contract are unknown at the time of the trade. A common practice is to buy a TBA security thirty to sixty days in advance of the issue date with the issue date as the trade settle date, then selling the security four days before issue date, with the same settle date. This allows the trader to realize a gain or loss on the security based on changes in interest rates, without taking possession of, or paying for, the security. The only cash cost is the broker cost of the trades. These have minimal credit risk, while this scenario is designed specifically to increase interest rate exposure.

Investment Derivative Fair Values

	June 30, 2011	Increases	Decreases	June 30, 2012
Options Written	$ 104,998	$ 4,077,627	$ (4,088,076)	$ 94,549
Pay Fixed Interest Swaps	(307,205)	1,145,482	(1,005,913)	(167,636)
Receive Fixed Int. Swaps	790,147	4,370,213	(4,713,886)	446,474
Credit Default Swaps	4,071,975	240,061,265	(244,622,334)	(489,094)
TBA Agency Bonds *	(112,261,173)	2,824,270,018	(2,499,509,795)	212,499,050
Foreign Currency Forwards	(10,651,672)	151,658,083	(132,749,555)	8,256,856
	$ (118,252,930)	$ 3,225,582,688	$ (2,886,689,559)	$ 220,640,199

*TBA Agency Bond notional values are equal to their fair values.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment Derivatives (Continued)

Investment Derivatives—Foreign Currency Forwards

The Retirement System's international investment managers use forward contracts to obtain currencies necessary for trade execution and manage the exposure of the international investments to fluctuations in foreign currency. Active international investment managers use forward contracts to enhance returns or to control volatility. 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 the terms of their contractual obligations. Since the System holds the offsetting currency in the contract, and controls are established by the investment managers to monitor the creditworthiness of the counterparties, risk of actual loss are minimized. The Retirement System also contracts with a currency overlay manager to hedge the currency exposure to the System's international equity portfolio.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment Derivatives (Continued)

Investment Currency Forwards

	June 30, 2011				June 30, 2012	
	Notional $USD	Fair Values	FV Increases	FV Decreases	Fair Values	Notional $USD
Australian Dollar	$ 183,400,821	$ 418,196	$ 11,562,586	$ (12,109,515)	$ (128,733)	$ 32,281,579
Brazil Real	40,766,316	179,904	150,975	(299,390)	31,489	7,544,316
British Pound	221,092,354	2,117,397	12,900,666	(14,596,023)	422,040	67,419,737
Canadian Dollar	114,398,747	(932,853)	4,919,426	(4,331,372)	(344,799)	37,667,318
Chinese Yuan Ren	18,823,310	76,218	-	(108,083)	(31,865)	7,680,592
Danish Krone	-	-	788,980	(572,483)	216,497	4,964,720
Euro Currency Unit	475,501,707	(419,064)	40,727,339	(38,390,311)	1,917,964	232,856,452
Hong Kong Dollar	99,691,366	36,439	370,083	(409,971)	(3,449)	29,431,197
Hungarian Forint	4,456,321	(176,542)	176,542	-	-	-
Indonesian Rupian	5,352,001	150,823	78,505	(285,877)	(56,549)	6,622,148
Japanese Yen	385,814,416	1,151,226	6,414,191	(7,861,040)	(295,623)	118,036,073
Malaysian Ringgit	4,270,424	34,803	8,376	(49,883)	(6,704)	600,000
Mexican New Peso	26,003,462	462,078	4,526,749	(6,436,176)	(1,447,349)	45,525,952
New Taiwan Dollar	597,861	7,426	5,589	(13,015)	-	-
New Zealand Dollar	35,058,302	(451,640)	1,009,776	(547,971)	10,165	1,314,263
Norwegian Krone	57,516,995	534,930	1,776,663	(2,274,868)	36,725	1,634,005
Other Currencies	13,660,534	123,275	234,872	(390,756)	(32,609)	3,729,366
Philippines Peso	6,784,703	(15,208)	34,435	(610)	18,617	505,131
S African Rand	7,348,173	56,914	299,471	(444,868)	(88,483)	4,386,757
Singapore Dollar	37,853,284	150,312	2,070,461	(2,318,474)	(97,701)	11,057,213
South Korean Won	8,078,451	199,538	29,514	(293,480)	(64,428)	5,859,081
Swedish Krona	62,655,125	321,182	1,518,498	(1,938,928)	(99,248)	3,274,430
Swiss Franc	93,314,287	841,059	10,891,335	(12,271,329)	(538,935)	14,981,385
	$ 1,902,438,960	$ 4,866,413	$ 100,495,032	$ (105,944,423)	$ (582,978)	$ 637,371,715

Hedging Currency Forwards

	June 30, 2011				June 30, 2012	
	Notional $USD	Fair Values	FV Increases	FV Decreases	Fair Values	Notional $USD
Australian Dollar	$ 11,346,264	$ (136,944)	$ 3,725,248	$ (3,022,082)	$ 566,222	$ 122,470,396
Canadian Dollar	61,076,609	(860,256)	1,556,238	(112,250)	583,732	81,960,799
Swiss Franc	51,278,025	(862,793)	11,702,322	(7,798,310)	3,041,219	109,025,837
Euro Currency Unit	425,928,943	(9,984,186)	18,142,843	(1,884,874)	6,273,783	256,120,592
British Pound	276,850,988	(1,320,074)	5,392,132	(4,315,058)	(243,000)	263,994,679
Hong Kong Dollar	35,977,938	745	70,783	(71,528)	-	-
Japanese Yen	162,085,701	(2,354,577)	10,573,485	(9,601,030)	(1,382,122)	264,399,290
	1,024,544,468	(15,518,085)	51,163,051	(26,805,132)	8,839,834	1,097,971,593
Total Curency Forwards	$ 2,926,983,428	$ (10,651,672)	$ 151,658,083	$ (132,749,555)	$ 8,256,856	$ 1,735,343,308

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Hedging Derivatives

Foreign Currency Forwards:

The Retirement System utilizes a currency overlay manager to reduce, or partially hedge, the System's exposure to foreign currencies through the international equities portfolio. The overlay manager evaluates the System's international equities exposure to currencies, and (buys/sells) inverse currency forwards in relation to the overall currency exposures. The inverse relationship of these hedging forwards uses their exposure to currency risks to reduce overall System exposure. The Statement of Investment Policy stipulates that the overlay manager should: "Take forward currency exchange contract positions which will have the intent and effect of hedging the currency exposure of the underlying international equity assets." The Statement of Investment Policy further states the forward currency exchange contract positions be used to "Maintain an acceptable risk level by reducing the negative volatility of the currency component of return."

The Retirement System has ongoing foreign currency exposure through its international equities portfolio. At June 30, 2012, the market values of international equities was $3.18 billion. The System's exposure to foreign currencies is converted into a proxy basket of seven liquid currencies that are highly correlated to the movements of the underlying currencies. The weights to be used are calculated with reference to the liquidity and risk of each currency. There is appropriate statistical evidence that the proxy basket does track the currency exposure closely (residual standard deviation of less than one percent). This proves the intent is to hedge and qualifies as a designated hedge under Generally Accepted Accounting Principles. The forward contracts are purchased as needs are determined by the hedge manager, and mature in the nearest September or March. Gains/losses are realized during those periods and the contracts are rolled over to the next period as appropriate. Through these processes, hedging contracts can adapt to any changes to portfolio currency exposures. Since the hedging currency forwards track to the overall exposure, and they reference the same foreign exchange rates as the underlying portfolio, this hedge is known to be effective through consistent critical terms.

A portfolio hedge such as this does not match the hedging forwards to any specific hedged security. The accessibility and liquidity of the currency forwards market allows these hedging forwards to roll forward and seamlessly hedge the ongoing foreign currency exposures. Counterparties to these forwards are carefully analyzed for credit risk. The System has control of one side of the exchange at all times, thereby reducing the costs of a counterparty default to possible lost gains, and inconvenience costs required to re-establish the hedge on short notice with another counterparty.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Hedging Derivatives

Foreign Currency Forwards (Continued)

Investment Forwards Counterparty Exposure

	By Counterparty at June 30, 2012		Standard & Poor
Counterparty Name	Notional $USD	Fair Value	Long Term Rating
Bank of New York Mellon	$ 18,252,440	$ 28,426	A+
Barclays	85,244,310	(1,147,365)	A
BNP Paribas	39,040,219	70,000	A+
Citigroup Inc	35,645,547	103,094	A-
Credit Suisse Group	62,293,617	1,455,106	A
Deutsche Bank	43,643,551	(87,664)	A+
Goldman Sachs Group Inc	6,919,879	(25,376)	A-
HSBC Holdings	26,187,863	223,782	A+
JPMorgan Chase & Co	12,521,522	(96,203)	A
Morgan Stanley	16,835,146	(908,122)	A-
Royal Bank of Canada	83,108,832	958,727	AA-
Royal Bank of Scotland	18,583,504	(172,001)	AAA
Societe Generale	1,743,570	(15,216)	A
State Street Corp	20,696,571	(221,978)	A+
UBS	115,079,035	194,691	A
Westpac Banking Corp	51,576,110	(942,879)	AA-
	$ 637,371,716	$ (582,978)	

Hedging Forwards Counterparty Exposure

	By Counterparty at June 30, 2012		Standard & Poor's
Counterparty Name	Notional $USD	Fair Value	Long Term Rating
Barclays	$ 196,638,147	$ 2,977,106	A
Citigroup Inc	116,236,891	(967,285)	A-
Deutsche Bank	72,363,951	415,017	A+
HSBC Holdings	196,172,816	5,963,452	A+
JPMorgan Chase & Co	170,461,427	(1,374,115)	A
Royal Bank of Canada	224,877,687	(1,275,626)	AA-
Royal Bank of Scotland	27,542,038	(549,160)	AAA
UBS	93,678,637	3,650,445	A
	$ 1,097,971,594	$ 8,839,834	

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets and Supplies Inventory

Furniture, fixtures and equipment are reported on the Statement of Plan Net Assets 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, 2012, was $14,223,886. Office supplies inventory in the amount of $21,575 is included, assuming the first-in, first-out method. In fiscal year 1999, the Retirement System purchased an office building and 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 50 percent is a real estate investment. The administrative portion of the building and 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, 2012 was $2,628,139. The office building and garage are being depreciated over a period of 33 years on an accelerated method. At June 30, 2012, the carrying value of the System's administrative headquarters was $990,018.

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 will be liquidated by the State's governmental and internal service funds.

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. This law requires the actuary to.

- Make an annual valuation of the Retirement System's liabilities and reserves.
- Make a determination of the contributions required to discharge the Retirement System's liabilities.
- Recommend to the Board of Trustees employer contribution rates required to maintain the System on an actuarial reserve basis.

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 8.0 percent 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 4.0 percent per year. The balance at June 30, 2012, was $5,334,463,714, and was fully funded.

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, 2012, was $7,036,377,742. The unfunded liability was $9,228,149,871. 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, 2012, was $9,923,525,468. 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, 2012, was $20,533,133, 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, 2012, was negative $6,800.

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 2012, the regular employer contribution rate was 8.77 percent of covered payroll. In addition, KPERS contributed an additional 1.0 percent of covered payroll to the group insurance fund. Total payroll was $4,190,789, $3,915,928 and $4,414,614 for 2010, 2011 and 2012 respectively. KPERS contributed $323,173, $359,518 and $379,168 for 2010, 2011 and 2012 respectively, to the employees pension plan and group insurance fund. All contributions required by law were made in fiscal years 2010, 2011 and 2012.

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 $231,534,281 at June 30, 2012.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New Governmental Accounting Standards Board Statements

GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position was issued June 2011 and is effective for fiscal years beginning after December 15, 2011. Concepts Statement No. 4, Elements of Financial Statements, introduced those concepts. This Statement supersedes several paragraphs in GASB Statements No. 25 and 27 and will be effective for the System in fiscal year 2013.

GASB Statement No. 64, Derivative Instruments: Application of Hedge Accounting Terminations Provisions-an amendment of GASB Statement No. 53, was issued in June 2011 and is effective for fiscal years beginning after June 15, 2011. Some governments have entered into interest rate swap agreements and commodity swap agreements in which a swap counterparty, or the swap counterparty's credit support provider, commits or experiences either an act of default or a termination event as both are described in the swap agreement. For fiscal year ending June 30, 2012, the System did not have any swaps used as hedges.

GASB Statement No. 65, Items Previously Reported as Assets and Liabilities, was issued in March 2012 and is effective for fiscal years beginning after December 15, 2012. It establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities. This statement will be effective for the System in fiscal year 2014.

Two new GASB Statements have been issued that will have major impacts on how the System reports. These statements are the most significant changes to the way defined benefit pension assets and liabilities are reported since the original statements were issued in 1994. Statement No. 67, Financial Reporting for Pension Plans is effective for fiscal years beginning after June 15, 2013. Statement No. 68, Accounting and Financial Reporting for Pensions is effective for fiscal years beginning after June 15, 2014. The objective of these 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 GASB Board will also issue implementation guides. The implementation guide for Statement No. 67 will be issued in June 2013. The implementation guide for Statement No. 68 will be issued in January 2014.

KPERS' management is currently evaluating the effect of all of the GASB statements referenced above on the Systems' financial statements.

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, 2009. As a result of this study, the Board of Trustees adopted 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.

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 2012 KPERS transferred to the State of Kansas $3,210,092 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, 2010, and December 31, 2011, can be attributed to the following ($ millions):

Unfunded Actuarial Liability, December 31, 2010	$8,264.00
Effect of contribution cap/time lag	289.50
Expected increase due to amortization method	62.00
Loss from investment return	852.60
Demographic experience	(192.00)
All other experience	1.80
Change in actuarial assumptions	(64.40)
Change in benefit provisions	14.60
Final Unfunded Actuarial Liability, December 31, 2011	$9,228.10

NOTE 3: FUNDING POLICY (CONTINUED)

Contributions Required and Contributions Made

KPERS. The actuarially determined contribution rates are computed as a level percentage of payroll by the Retirement System's actuary. For the State/School 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.

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:

Fiscal Year	Actuarial Rate	Statutory Rate
State/School		
2011	11.30%	8.17%
2012	14.09%	8.77%
Correctional		
2011	9.20% / 8.64%	8.55% / 8.50%
2012	12.92% / 9.24%	11.86% / 9.10%

Included in the fiscal year 2011 and 2012 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, 2008, and December 31, 2009, actuarial valuations provide the basis for Board certification of local employer contribution rates for fiscal years beginning in 2011 and 2012, respectively. The actuarially determined employer contribution rates and statutory contribution rates are as follows:

Local

Fiscal Year	Actuarial Rate	Statutory Rate
2011	10.42%	6.74%
2012	9.44%	7.34%

KP&F

The uniform participating service rate for all KP&F employers was 14.57 percent for the fiscal year beginning in 2011 and 16.54 percent for the fiscal year beginning in 2012. KP&F employers also make contributions to amortize the liability for past service costs, if any, which are determined separately for each participating employer.

NOTE 3: FUNDING POLICY (CONTINUED)

Contributions Required and Contributions Made (Continued)

Judges

The total actuarially determined employer contribution rate was 19.49 percent of payroll for the fiscal year ended 2011 and 21.28 percent of payroll for the fiscal year ended 2012.

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 (in thousands):

Employer and Employee Contributions
(in thousands)

	Employer and Insurance Contributions	Member Contributions (1)	Contributions as a Percent of Covered Payroll
KPERS- State	$ 100,222	$ 44,520	12.1 %
KPERS- School	312,963	142,361	12.7
KPERS - Local	126,140	72,471	11.0
KP&F	72,384	31,073	24.2
Judges	5,927	1,469	26.7
Subtotal	**$ 617,636**	**$ 291,894**	**12.9 %**

An estimated $588 million of employer & employee contributions were made to cover normal cost, an estimated $321 million was made for the amortization of the unfunded actuarial accrued liability.

1) Member contributions do not include Optional Life Insurance contributions of approximately $6.2 million.

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)
12/31/11	$13,379,050	$22,607,170	$9,228,150	59%	$6,401,462	144%

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	12/31/2011	12/31/2011	12/31/2011
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	21 years	21 years	21 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 active 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.

NOTE 4: OTHER POST EMPLOYMENT BENEFIT PLAN — KPERS DEATH AND DISABILITY PLAN (CONTINUED)

Summary of Significant Accounting Policies

Basis of Accounting Policies
The KPERS Death and Disability Plan'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.

Plan Membership and Benefits

Members in the Death and Disability Plan consisted of the following at June 30, 2010, the date of the last actuarial valuation:

Active plan members,	164,835
Number of participating employers	1,417
Open claims	2,882

The Death and Disability Plan provides two primary benefits to active members:

- Group life insurance equal to 150 percent of annual compensation, which is provided through an insurance contract with an insurance carrier.

- Self-insured long-term disability (LTD) benefits equal to 60 percent (before January 1, 2006, 66 2/3 percent) 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 one percent, 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.

NOTE 4: OTHER POST EMPLOYMENT BENEFIT PLAN — KPERS DEATH AND DISABILITY PLAN (CONTINUED)

Contributions and Funded Status (Continued)

Calendar year 2002 and 2003 legislation placed additional moratoriums on contributions. 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. Legislation passed in early 2009 placed a moratorium on contributions related to the group life insurance and disability benefits effective for the period March 1, 2009, through November 30, 2009. Subsequently, the Legislature passed moratoriums on contributions for each of the following periods, April 1, 2010 through June 30, 2010, April 1, 2011 through June 30, 2011 and April 1, 2012 through June 30, 2012. For the period ending June 30, 2012, employers contributed over $49 million to the Plan.

The death and disability plan assets are held in the Group Insurance Reserve fund. At June 30, 2012, this reserve held net assets totaling $19,068,466. This reserve fund is funded from deposits from employer contributions and the respective investment income. Administrative expenses for the death and disability plan are funded from the accumulated investment income of the fund.

The funding status of the plan at June 30, 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)
6/30/10	$12,751	$283,758	$271,007	4.5%	$6,822,726	4.0%

The actuarial valuation dated March 1, 2011, is the most recent actuarial valuation. 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 for the Death and Disability Plan (on page 43) 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.

NOTE 4: OTHER POST EMPLOYMENT BENEFIT PLAN — KPERS DEATH AND DISABILITY PLAN (CONTINUED)

Contributions and Funded Status (Continued)

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 does 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.

The accompanying schedule of employer contributions (on page 42) 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, 2010, 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. 6/30/2010

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 [1]	4.5%
Projected salary increases [1]	4.0%–12.0%
Payroll Growth	4.0%

[1] Salary increases and investment rate of return include a 3.25 percent inflation component.

NOTE 5: COMMITMENTS AND CONTINGENCIES

As of June 30, 2012, the Retirement System was committed to additional funding of $7,159,000 in the form of capital expenditures on separate account real estate holdings in the portfolio, $317,355,000 for commitments on private equity investments, and $261,674,000 for capital calls on core and non-core real estate property trust investments.

The Retirement System is a defendant in legal proceedings and claims arising out of the ordinary course of business. The Retirement System believes 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.

NOTE 6: SUBSEQUENT EVENTS

Subsequent events have been evaluated through October 15, 2012, which is the date the financial statements were available to be issued.

REQUIRED SUPPLEMENTARY INFORMATION

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF EMPLOYER CONTRIBUTIONS - RETIREMENT PLAN

FISCAL YEAR ENDED JUNE 30, 2012

Year Ended June 30	Annual Required Contribution	Percentage Contributed
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
2009	660,833,664	68.0
2010	682,062,413	72.1
2011	709,964,322	74.0
2012	843,361,835	67.4

*This schedule does not include Death & Disability Insurance contributions as a component of required contributions.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF FUNDING PROGRESS - RETIREMENT PLAN

FISCAL YEAR ENDED JUNE 30, 2012

(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)
12/31/02	$ 9,784,862	$ 12,613,599		$ 2,828,736	78%	$ 4,865,903	(1)	58%
12/31/03	10,853,462	14,439,546	(2)	3,586,084	75%	4,978,132		72%
12/31/04	10,971,427	15,714,092		4,742,666	70%	5,102,016		93%
12/31/05	11,339,293	16,491,762		5,152,469	69%	5,270,351		98%
12/31/06	12,189,197	17,552,790		5,363,593	69%	5,599,193		96%
12/31/07	13,433,115	18,984,915		5,551,800	71%	5,949,228		93%
12/31/08	11,827,619	20,106,787		8,279,168	59%	6,226,526		133%
12/31/09	13,461,221	21,138,206		7,676,985	64%	6,532,496		118%
12/31/10	13,589,658	21,853,783		8,264,125	62%	6,494,048		127%
12/31/11	13,379,020	22,607,170		9,228,150	59%	6,401,462		144%

(1) Beginning with the 12/31/02 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.

(2) Beginning with the 12/31/03 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, 2012

Year Ended June 30	Annual Required Contribution	Percentage Contributed
2007	$ 71,763,879	82.6%
2008	76,128,451	82.0%
2009	75,414,841	48.2%
2010	62,705,453	47.1%
2011	57,868,502	84.5%
2012	57,030,698	87.0%

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF FUNDING PROGRESS - DEATH AND DISABILITY PLAN

FISCAL YEAR ENDED JUNE 30, 2012

(Dollar amounts in thousands)

Actuarial Valuation Date		Actuarial Value of Assets (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)
06/30/06	(1)	$ 18,724	$ 354,150	$ 335,426	5.3 %	$ 5,716,896	5.9 %
06/30/07		25,568	355,729	330,161	7.2 %	5,981,324	5.5 %
06/30/08		38,571	355,060	316,489	10.9 %	6,409,426	4.9 %
06/30/10		12,751	283,758	271,007	4.5 %	6,822,726	4.0 %

(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, 2012

Kansas Public Employees Retirement System			
State / School Contributions			
Members	$186,881,551		
Employers	413,185,313		
Total State / School Contributions		$600,066,864	
Local Contributions			
Members	72,471,313		
Employers	126,139,677		
Total Local Contributions		198,610,990	
Total Contributions - Kansas Public Employees Retirement System			**$798,677,854**
Kansas Police and Firemen's System			
State Contributions			
Members	2,910,439		
Employers	5,835,093		
Total State Contributions		8,745,532	
Local Contributions			
Members	28,162,308		
Employers	66,549,183		
Total Local Contributions		94,711,491	
Total Contributions - Kansas Police and Firemen's System			**103,457,023**
Kansas Retirement System for Judges			
State Contributions			
Members	1,468,700		
Employers	5,926,968		
Total State Contributions		7,395,668	
Total Contributions - Kansas Retirement System for Judges			**7,395,668**
Optional Life Insurance			
Member Contributions			
State Employees	3,143,070		
Local Employees	3,067,672		
Total Contributions		6,210,742	
Total Contributions - Optional Life Insurance			**6,210,742**
GRAND TOTAL - ALL CONTRIBUTIONS			**$915,741,287**

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF ADMINISTRATIVE EXPENSES

FISCAL YEAR ENDED JUNE 30, 2012

Salaries and Wages		$ 5,761,218
Professional Services		
Actuarial	$ 470,403	
Audit	39,400	
Data Processing	228,229	
Legal	76,462	
Other Professional Services	629,062	1,443,556
Total Professional Services		
Communication		
Postage	202,905	
Printing	57,609	
Telephone	94,281	
Total Communication		354,795
Building Administration		
Building Management	57,715	
Janitorial Service	23,050	
Real Estate Taxes	48,869	
Utilities	40,360	
Total Building Administration		169,994
Miscellaneous		
Dues and Subscriptions	20,329	
Repair and Maintenance	731,599	
Office and Equipment Rent	18,025	
Supplies	74,861	
Temporary Services	8,502	
Travel	76,537	
Other Miscellaneous	133,516	
Depreciation	1,208,114	
Total Miscellaneous		2,271,483
Total Administrative Expenses		$ 10,001,046

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

SCHEDULE OF INVESTMENT INCOME BY ASSET CLASS

FISCAL YEAR ENDED JUNE 30, 2012

Asset Classification	**Interest, Dividends and Other Transactions**	**Gains and Losses**	**Total**
Marketable Equity Securities			
Domestic Equities	$ 30,797,600	$ 124,042,669	$ 154,840,269
International Equities	73,048,319	(496,802,945)	(423,754,626)
Subtotal Marketable Equities	103,845,919	(372,760,276)	(268,914,357)
Marketable Fixed Income Securities			
Government	33,102,258	162,031,616	195,133,874
Corporate	69,663,378	4,969,895	74,633,273
Subtotal Marketable Fixed	102,765,636	167,001,511	269,767,147
Temporary Investments	829,536	12,184,428	13,013,964
Total Marketable Securities	207,441,091	(193,574,337)	13,866,754
Real Estate	44,259,544	52,533,847	96,793,391
Alternative Investments	7,056,940	8,311,234	15,368,174
Total Real Estate and Alternative Investments	51,316,484	60,845,081	112,161,565
Other Investment Income			
Securities Lending	4,817,667	-	4,817,667
Reimbursement for Non-KPERS Costs	436,311		436,311
Total Other Investment Income	5,253,978	-	5,253,978
Investment Income	$ 264,011,553	$ (132,729,256)	131,282,297
Manager and Custodian Fees and Expenses			
Investment Manager Fees			(29,424,955)
Custodian Fees & Expenses			(815,138)
Other Investment Expenses			(1,775,729)
Partnership Mgmt Fees & Expenses			(10,209,841)
Total Investment Fees and Expenses			(42,225,663)
Net Investment Income			$ 89,056,634

KANSAS PUBLIC EMPLOYEE RETIREMENT SYSTEM

SCHEDULE OF INVESTMENT FEES AND EXPENSES

FISCAL YEAR ENDED JUNE 30, 2012

Domestic Equity Managers		
BlackRock	$ 52,687	
Fiduciary Asset Management Co.	357,875	
ING	1,087,718	
Loomis, Sayles & Co.	959,389	
Mellon CM LC Index	218,147	
Security Global Investors	874,656	
Systematic Financial Mgmnt.	840,902	
Subtotal Domestic Equity Managers		$ 4,391,374
Global Equity Managers		
Capital Guardian Trust Co.	1,218,341	
Wellington Management Co.	1,469,336	
Subtotal Global Equity Managers		2,687,677
International Equity Managers		
Baillie Gifford	2,440,361	
BlackRock	413,675	
Barings	1,639,558	
JP Morgan Int'l	2,186,003	
Lazard Freres Asset Management	1,263,078	
Morgan Stanley Asset Management	967,227	
Nomura Capital Management	183,795	
State Street	66,700	
Templeton Int'l	1,487,844	
Subtotal International Equity Managers		10,648,241
Fixed Income Managers		
BlackRock	232,029	
Loomis, Sayles & Co.	992,981	
MacKay Shields	917,994	
Pacific Investment Management Co.	2,656,586	
T. Rowe Price	927,750	
Western Asset Management Co.	513,882	
Subtotal Fixed Income Managers		6,241,222
Foreign Currency Overlay Manager		
Portable Alpha	(160,760)	
Barclays	185,417	
Pareto Partners	1,320,000	
Russell	493,625	
Subtotal Foreign Currency Overlay Manager		1,838,282
Real Estate & Alternative Investment Managers		
AEW Capital Management	2,426,749	
Brookfield Redding	637,108	
Duff & Phelps	129,285	
Principal	115,472	
Subtotal Real Estate & Alternative Managers		3,308,614
Cash Equivalent Manager		
Payden & Rygel Investment Counsel	309,544	
Subtotal Cash Management		309,544
Total Investment Management Fees		29,424,954
Other Fees and Expenses		
Mellon Trust - Custodian Fees and Other Expenses	815,138	
Consultant Fees	1,600,303	
Litigation Expenses	175,426	
Partnership Management Expenses	10,209,842	
Subtotal Other Fees and Expenses		12,800,709
Total		$ 42,225,663

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

INVESTMENT SUMMARY
(In Thousands) (1)

FISCAL YEAR ENDED JUNE 30, 2012

	June 30, 2011 Fair Value	Purchases and Other Increases	Sales and Other Decreases	June 30, 2012 Fair Value	Asset Mix Fair Value
Marketable Securities:					
Domestic Equities	$ 3,786,594	$ 3,444,598	$ (2,730,831)	$ 4,500,361	33.90%
International Equities	3,871,749	4,532,974	(5,221,949)	3,182,774	23.97%
Total Fixed Income	3,801,271	6,166,811	(6,262,579)	3,705,503	27.91%
Temporary Investments	365,569	20,376,097	(20,536,216)	205,450	1.55%
Total Marketable Securities	11,825,183	34,520,480	(34,751,575)	11,594,088	87.32%
Real Estate and Alternative Investments:					
Real Estate	1,041,729	630,860	(376,729)	1,295,860	9.76%
Alternatives	369,393	201,554	(183,748)	387,199	2.92%
Total Real Estate and Alternative Investments	1,411,122	832,414	(560,477)	1,683,059	12.68%
Total Investments	$ 13,236,305	$ 35,352,894	$ (35,312,052)	$ 13,277,147	100.00%

(1) Amounts include changes in unrealized appreciation and exclude interest and dividend accruals. Amounts exclude security lending cash collateral of $960,689,299 for FY 2011, and FY 2012 cash collateral of $1,051,425,908

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

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

EXPENSE BY TYPE

FISCAL YEAR ENDED JUNE 30, 2012

Fiscal Year	Benefits	Refund of Contributions		Insurance	Administration (Retirement)	Insurance (OPEB)	Administration (OPEB)*	Total
		Separations	Death					
2003	$ 653,542,143	$ 34,462,966	$ 5,145,980	$ 8,267,916	$ 7,215,024	$ 45,561,319	$ -	$ 754,195,348
2004	685,603,796	35,903,879	5,275,591	6,362,986	7,231,295	44,033,406	-	784,410,953
2005	745,413,160	40,395,640	6,378,293	5,997,113	7,340,147	47,705,996	-	853,230,349
2006	814,789,655	40,628,580	6,197,596	5,973,688	7,718,879	48,984,269	-	924,292,667
2007	877,332,611	40,632,701	5,496,510	6,383,962	8,552,925	49,201,924	340,619	987,941,252
2008	954,093,592	43,197,593	5,275,097	6,824,361	9,253,050	49,893,770	350,076	1,068,887,539
2009	1,009,177,354	38,156,001	5,773,422	6,946,461	11,085,498	47,356,797	361,887	1,118,857,420
2010	1,069,165,206	37,214,954	6,147,736	7,035,185	10,158,398	43,746,954	375,792	1,173,844,225
2011	1,156,823,960	43,579,892	5,984,123	6,752,185	9,261,262	46,753,126	363,357	1,269,517,905
2012	1,246,974,132	49,665,542	6,231,284	6,128,984	9,693,869	49,040,446	307,177	1,368,041,434

* Administration expenses for the Group Death and Disability Plan prior to fiscal year 2007 are included in the administrative expenses of the Retirement System.

CHV & Co

COCHRAN HEAD VICK & CO., P.A.

Certified Public Accountants

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Independent Auditors' 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 (KPERS), a component unit of the State of Kansas as of and for the year ended June 30, 2012, and have issued our report thereon dated October 15, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting
Management of KPERS is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered KPERS' 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 KPERS' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of KPERS' internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether KPERs' 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*.

We noted certain matters that we reported to management of KPERS', in a separate letter dated October 15, 2012.

This report is intended solely for the information and use of the Legislative Post Audit Committee, the Board of Trustees, and management and should not be used by anyone other than these specified parties.

October 15, 2012 Cochran Head Vick & Co, P.C

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM

REQUIRED COMMUNICATIONS

June 30, 2012

CHV & Co

COCHRAN HEAD VICK & CO., P.A.

Certified Public Accountants

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October 15, 2012

To the Board of Trustees and Management
Kansas Public Employees Retirement System

We have audited the financial statements of the Kansas Public Employee Retirement System (KPERS or the System), a component unit of the State of Kansas, as of and for the year ended June 30, 2012. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated February 7, 2012. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the System are described in Note 2 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the System during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the System's financial statements are the estimates used to determine the actuarial assumptions and methods used by the actuary to prepare the annual actuarial valuation report. The actuarial valuation report is used to determine the recommended funding amounts for the System as well as for fulfilling financial reporting requirements. We evaluated the key factors and assumptions used to develop the actuarial assumptions and methods and determined that they are reasonable in relation to the financial statements taken as a whole.

Another key estimate is management's estimate of the fair value of alternative investments in limited partnerships which is based on the valuations of the underlying companies that comprise the investment portfolio of the limited partnerships. Many of these companies are privately held businesses for which objective fair value information based on market transactions is not readily available. We believe that the methods used to determine fair value of the alternative investments, as presented in the System's financial statements, is reasonable in all material respects.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing and completing our audit.

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Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. There were no corrected or uncorrected misstatements that were a result of our audit procedures.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 15, 2012.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the System's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the System's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Conclusion

This information is intended solely for the use of the Legislative Post Audit Committee, the Board of Trustees, and Management of KPERS and is not intended to be and should not be used by anyone other than these specified parties.

Cochran Head Vick & Co., P.A.