

## KENTUCKY RETIREMENT SYSTEMS

**TO:** Members of the Board

**FROM:** William A. Thielen, Esq.  
Executive Director

**DATE:** February 21, 2013

**SUBJECT:** Quarterly Reports of the Audit Committee

The Audit Committee held its quarterly meeting on November 1, 2012. The purpose of the meeting was to review and discuss, among other miscellaneous audit related items, the following:

➤ *Review of Refunds to Inactive Members*

*FINDINGS*

*Three refunds were fully issued to members, but Contributions and Interest (C&I) under these Member Profiles in START were noted as negative balance, instead of zero.*

*Three refunds were issued according to the contributions reported by the agencies. However, after the refunds were issued, agencies submitted negative prior period adjustments, and requested refund of over reported contributions. System accepted these negative adjustments in error (these negative adjustments should not have been accepted), and automatically issued these over reported contributions as refunds to the inactive member. Because these refunds were issued to the members, C&I balance was negative instead of zero. These negative balances indicate that over reported contributions, which were already paid to the members in error, should have been collected from the members and employers. These three over refunded amounts were \$124.14, \$37.08, and \$8.26.*

*The Divisions of Information Technology, Member Services, Retiree Services, and Accounting were previously aware of this over reported and over refunded contribution. Any refund which has a negative balance was stopped from processing the refund to the member through submitting Problem Incident Report (PIR) # 25159 in START*

issue tracker. Approximately 99 refund accounts with similar errors of a negative balance have been identified by the staff. The divisions are in the process to resolve this issue in START through submitting PIR # 23661 in issue tracker. Divisions are also in the process to correct this error by sending notification letters and invoices for over refunded member contributions to the members, and creating/sending manual monthly reporting invoices to the employer for the shortage of the employer contributions.

Besides this negative balance with over reported/refunded contributions error, divisions found a few other issues of errors in refunded accounts. Errors such as, refund adjustment (RADJ) rows were created in member accounts to offset the negative balance and to correct the account; however, RADJ rows were created erroneously in some refund accounts in which RADJ rows should not have been created. As a result, contributions were refunded in error. Another error is, if the refund member began new employment, active rows of member account erroneously coded and tied to refunded account, and employee contributions were refunded in error. The divisions are in the process to solve these issues in START through submitting PIRs # 25176, 25232, and 22372 in issue tracker. Divisions are also in the process to correct these errors by sending notification letters and invoices for over refunded member contributions to the members, and creating/sending manual monthly reporting invoices to employers. As of November 20, 2012, the accounts with the negative balances are in process to review and correct, and excessive refund contributions are in process to recover from the members who received refund contributions in error.

#### **RECOMMENDATIONS**

Divisions are previously aware of the issue of negative balance with over reported/refunded contributions. The Division of Information Technology and Division of Employment Services are in the process to resolve the issues through PIRs# 25159, 23661, 25176, 25232, and 22372 in START issue tracker. Internal Audit recommends that management should properly document and track all PIRs related to the errors in the refund accounts, and management should resolve issues in a timely manner.

*Note: PIR# 23661 was resolved on 6/19/2012. As of November 20, 2012, PIR #25159 is scheduled to be resolved in production build on 11/27/2012. Remaining PIRs have been deployed to production and in process to resolve.*

**MANAGEMENT'S COMMENTS**

*(Mr. Todd E. Coleman, CPA, Controller)*

*Agree with findings and recommendations*

**FINDINGS**

*The refunds report in START is pulling all refunds data instead of pulling a selected date range.*

*Under Reports-Refunds Report in START, the refunds report does not pull refunds data according to the specified date range, but it pulls all refunds with numerous pages of refunds. On November 3, 2011, Management submitted PIR# 22468 in issue tracker to resolve the refunds report issue; however, it is still an outstanding issue. Management submitted new PIR# 25293 in issue tracker.*

**RECOMMENDATIONS**

*When producing refunds report in START, refunds data on the report should be within the selected date range. The Division of Information Technology is in the process to resolve the refund report date range issue through PIR# 25293 in START issue tracker.*

*Note: As of November 20, 2012, this PIR is scheduled to be resolved in production build on 11/27/2012.*

**MANAGEMENTS' COMMENTS**

*(Mr. Todd E. Coleman, CPA, Controller)*

*Agree with findings and recommendations.*

- *Review of Management's Response to the Findings and Recommendations for the Investment Cash Flow Review – Dean, Dorton, Allen and Ford, PLLC*
- *Review of Quarterly Financial Statements – 12/31/2012*
- *Review of Management's Response to the External Audit dated June 30, 2012*

- *Review of Internal Audit Budget 12/31/2012*
- *Review of Anonymous Reporting*
- *Review of Investment Compliance Report*
- *Security Audits*
  - *Request for Third-Party Assessment of the START Application*
  - *Request for Third-Party Assessment of KRS' IT Infrastructure*
- *County Employees Retirement System Board Election Memoranda*
- *Kentucky Employees Retirement System Board Election Memoranda*
- *Auditor of Public Accounts (APA) FY 2013 Audit*

**RECOMMENDATION:** The Audit Committee requests that the Board ratify the actions taken by the Audit Committee.

## KENTUCKY RETIREMENT SYSTEMS

**TO:** Members of the Board

**FROM:** William A. Thielen  
Executive Director

**DATE:** February 21, 2013

**SUBJECT:** Retiree Health Plan Committee Report

The Committee met on Tuesday, February 12, 2013 to discuss the current status of the Medicare eligible health plan and related items.

A review of the medical and pharmacy claims reports for 2012 were presented to the Committee. There were no significant changes identified in the trends. A contributing factor analysis will be presented at a future committee meeting comparing the Medicare Advantage plan for 2013 to the 2012 KRS TPA (Third Party Administrator) plan.

Humana and KRS staff presented an overview of the transition from the KRS TPA plans to the Medicare Advantage plans. Member and provider outreach via seminars, phone and correspondence were discussed. An update on the disabled Retirees/Spouses/Dependants equitable relief was provided. The Committee Members discussed additional outreach to this group with phone calls and certified letters to ensure they had the opportunity to go to the Social Security Administration/Railroad Retirement Board and enroll in Medicare Part B effective 1/1/2013 and have the late enrollment penalty waived. They have also requested additional education be given to internal KRS divisions in order to inform retirees and dependants of the requirement to notify KRS when they receive Medicare Eligibility and that a change from the KEHP plans (non-Medicare plans) to the KRS Medicare Eligible plans would be required. The suggestion was made to consider adding information in a newsletter.

The Committee was updated by KRS staff in regards to the medical and pharmacy claims runoff provision in the UMR and Catamaran contracts of March 31, 2013. Staff also discussed the continuing CMS requirements for the past years EGWP (Employer Group Waiver Plan), for example; 4<sup>th</sup> quarter 2012 reporting due February 28, 2013 as well as a Part D Data Validation Audit of the calendar year 2012. Information was given to the board regarding the required prescription drug event claims reporting and the direct and indirect remuneration as well as the 2012 financial reconciliation with CMS in September 2013.



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**KENTUCKY RETIREMENT SYSTEMS**  
INVESTMENTS

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**TO:** Kentucky Retirement System Board of Trustees

**FROM:** T.J. Carlson, Chief Investment Officer

**DATE:** February 21, 2013

**SUBJECT:** Investment Committee Quarterly Report

The Investment Committee held its regularly scheduled meeting on February 5, 2013. The purpose of the meeting was to evaluate investment activities, program structure, management, controls, and performance results of the Pension and Insurance Funds, for the quarter ending December 31, 2012, along with various other subjects.

The meeting began with approval of the minutes for the previous Investment Committee meeting held on November 7th, 2012.

A Private Equity commitment of Euro 50 million to Triton Fund IV L.P. was reviewed, discussed and approved by the Investment Committee.

A Private Equity commitment of up to \$55 million to HIG Capital Partners V, L.P. was reviewed, discussed and approved by the Investment Committee. Note: It was also discussed that there is a high likelihood KRS may not receive the full desired allocation and may only receive an allocation of approximately \$25 million due to the large over-subscription to the fund.

Tom Masthay and Chris Schelling gave an educational session on placement agents, their various corporate/structural options and conflict of interest considerations within each structure. They also reviewed their article on placement agents that was published in the nationally recognized Journal of Private Equity. At the request of the Investment Committee, this educational session will be repeated at the upcoming annual Board Retreat so that all Board members can receive the information.

Chris Schelling and Albourne (Real Return consultant) gave the annual review for the Real Return program. There were no changes recommended to the Real Return Policy or Managers.

Chris Schelling and Albourne (Absolute Return consultant) gave the annual review for the Absolute Return program. There were no changes recommended to the Absolute Return Policy or Managers. Staff asked the Committee for direction on how staff should proceed with filling out the direct

hedge fund manager program with the goal of being 50% direct within five years. Staff recommends a total of approximately 18 to 25 direct hedge funds for proper diversification of this program. The pros and cons of four "ramp up" options were discussed in detail as outlined next: bring 10 managers each to a special Investment Committee meeting once this year and once next year, or; over the next two years, bring 1 to 2 hedge fund managers to each of the next 8 to 12 quarterly meetings in addition to our regularly scheduled manager presentations, thereby lengthening an average meeting by 1 to 1 ½ hours, or; bring in five managers every six months at either a regular or special Investment Committee meeting, or finally: bring a slate of five managers to the regular Investment Committee meetings with due diligence support from Staff, Albourne and one of our Fund of Fund providers for review and approval by the Investment Committee. Given the three layers of due diligence being provided, individual managers would not be required to present to the Committee.

The Investment Committee directed Staff and Albourne to proceed under option four as described above.

Ann Case presented the Quarterly Compliance report. The Management Update was given by the CIO which included a review of the standard quarterly reports. These reports include the: Monthly Performance Update; Compliance Net of Fees Report; Internally Managed Portfolio Asset Report; Internally Managed Portfolio Transactions Report; Partnership Investments Report; Securities Lending Report; Domestic Equity Commissions Report; Global Equity Commissions Report; Securities Litigation Report; Investment Division Expense Report and the quarterly Meeting and Related Expense Tracking Database. The December Asset Allocation report, Securities Lending update, the Standard Quarterly and Potential Future Topics List, and an overview of the supplied articles of interest were also provided. Questions were encouraged and addressed throughout the reports.

***Please see the next page for a summary of the Pension and Insurance performance information ending December 31, 2012.***

<b>Pension Funds Performance Overview</b>								
<b>Rates of Return (%) as of December 31, 2012</b>								
	<b>One Year</b>		<b>Three Years</b>		<b>Five Years</b>		<b>Ten Years</b>	
	<b>Fund</b>	<b>Index</b>	<b>Fund</b>	<b>Index</b>	<b>Fund</b>	<b>Index</b>	<b>Fund</b>	<b>Index</b>
<b>Equity</b>	17.11	17.19	7.41	8.01	0.48	0.05	7.72	7.81
<b>Fixed Income</b>	10.24	5.53	8.27	6.71	6.34	6.13	5.63	5.55
<b>Private Equity</b>	13.78	35.30	13.84	12.20	3.60	5.25	11.78	8.18
<b>Real Estate</b>	10.18	10.94	12.75	10.61	N/A		N/A	
<b>Absolute Return</b>	7.06	3.32	N/A		N/A		N/A	
<b>Real Return</b>	9.55	4.79	N/A		N/A		N/A	
<b>Cash Equivalents</b>	0.30	0.07	0.50	0.09	1.10	0.45	2.24	1.69
<b>Total Fund</b>	12.88	13.57	8.25	8.06	2.92	3.27	7.11	7.27

<b>Insurance Funds Performance Overview</b>								
<b>Rates of Return (%) as of December 31, 2012</b>								
	<b>One Year</b>		<b>Three Years</b>		<b>Five Years</b>		<b>Ten Years</b>	
	<b>Fund</b>	<b>Index</b>	<b>Fund</b>	<b>Index</b>	<b>Fund</b>	<b>Index</b>	<b>Fund</b>	<b>Index</b>
<b>Equity</b>	16.81	17.15	6.81	7.62	-0.13	-0.30	7.48	7.17
<b>Fixed Income</b>	10.01	5.53	8.12	7.26	6.75	6.07	6.56	6.17
<b>Private Equity</b>	12.43	35.30	13.93	12.13	4.53	3.42	9.47	7.27
<b>Real Estate</b>	10.23	10.94	14.43	10.61	N/A		N/A	
<b>Absolute Return</b>	7.16	3.32	N/A		N/A		N/A	
<b>Real Return</b>	9.02	4.79	N/A		N/A		N/A	
<b>Cash Equivalents</b>	0.47	0.07	0.33	0.09	0.70	0.45	2.18	1.69
<b>Total Fund</b>	12.17	13.16	7.60	8.49	0.98	1.55	7.39	7.54

**RECOMMENDATION:** The Board is requested to ratify the actions of the Investment Committee.



## KENTUCKY RETIREMENT SYSTEMS

**TO:** Members of the Board

**FROM:** William A. Thielen  
Executive Director

**DATE:** February 21, 2013

**SUBJECT:** Actuarial Consulting Services Contract

KRS' current one-year contract for actuarial services with Cavanaugh Macdonald Consulting, LLC will expire June 30, 2013. If you recall, in May 2012, I brought to the Board the issue of approving a contract for actuarial services since the original contract with Cavanaugh Macdonald was due to expire on June 30, 2012. We received three responses to a Request for Proposals for Actuarial Services which was issued in April 2012. A copy of the memorandum summarizing the grading of the responses to the actuarial RFP that was provided to the Board at its May 2012 meeting accompanies this memorandum. The Board decided at the May 2012 meeting that board members should review the responses of the actuarial firms and decide on awarding the actuarial contract for a period of three years with three annual renewal options at a later date. In the meantime, the Board approved a one-year extension of the contract with Cavanaugh Macdonald, the firm that has served as KRS' actuary since 2006.

Since the May 2012 meeting, I contacted each of the responding actuarial firms and requested that they provide an update of their original cost proposal for providing actuarial services to KRS for the 2014, 2015 and 2016 fiscal years and for the optional one-year renewal periods thereafter. The updated cost proposals of the three firms are enclosed with this memorandum.

**RECOMMENDATION:** The Executive Director recommends that the KRS Board select a firm to provide actuarial services to KRS for the period 2014 through 2016 with three optional one-year renewal periods based on the original responses to the April 2012 RFP and the updated cost proposals.

**KENTUCKY RETIREMENT SYSTEMS**

**TO:** Members of the Board  
**FROM:** William A. Thielen  
**DATE:** February 21, 2013  
**SUBJECT:** Participation of Additional Agencies and Hazardous Positions

PARTICIPATION—NONHAZARDOUS

There are no agencies electing to participate with the County Employees Retirement System at this time.

**THE FOLLOWING AGENCIES ARE ASKING FOR HAZARDOUS DUTY COVERAGE ON POSITIONS FOR EMPLOYEES WHO HAVE A PARTICIPATION DATE PRIOR TO SEPTEMBER 1, 2008.**

The Buechel Fire District has requested hazardous duty coverage for the following positions with an effective date of March 1, 2013:

**Fire Chief**

**Deputy Chief – Safety & Support**

There are no employees to be covered under hazardous duty at this time. Attached are copies of the Position Questionnaires and Job Descriptions.

The City of Pikeville has requested hazardous duty coverage for the following position with an effective date of March 1, 2013:

**Patrol Lieutenant**

There are no employees to be covered under hazardous duty at this time. Attached is a copy of the Position Questionnaire and the Job Description.

Murray State University has requested hazardous duty coverage for the following positions with a **retroactive** date of January 1, 2013:

**Captain-Administration**

**Captain - Operations**

There are two (2) employees to be covered under hazardous duty at this time. Attached are copies of the Position Questionnaires and the Job Descriptions.

The City of Edgewood has requested hazardous duty coverage for the following position with a **retroactive** date of December 1, 2012:

**Firefighter/Paramedic – ALS Coordinator**

There is one (1) employee to be covered under hazardous duty at this time. Attached is a copy of the Position Questionnaires and the Job Description.

The City of Edgewood has requested hazardous duty coverage for the following position with an effective date of May 1, 2013:

**Firefighter/Paramedic**

There are no employees to be covered under hazardous duty at this time. Attached is a copy of the Position Questionnaires and the Job Description.

**HAZARDOUS POSITIONS (FOR EMPLOYEES HIRED 9/1/08 OR AFTER)**

The Buechel Fire District has requested hazardous duty coverage for the following positions with an effective date of March 1, 2013:

**Fire Chief**

**Deputy Chief – Safety & Support**

There are no employees to be covered under hazardous duty at this time. Attached are copies of the Position Questionnaires and Job Descriptions.

The City of Anchorage has requested hazardous duty coverage for the following positions with an effective date of March 1, 2013:

**Police Officer**

There is one (1) employee to be covered under hazardous duty at this time. Attached is a copy of the Position Questionnaire and the Job Description.

The Spencer County Fire District has requested hazardous duty coverage for the following positions with an effective date of March 1, 2013:

**Fire Captain**

There are no employees to be covered under hazardous duty at this time. Attached are copies of the Position Questionnaire and Job Descriptions.

The City of Edgewood has requested hazardous duty coverage for the following position with a **retroactive** date of December 1, 2012:

**Firefighter/Paramedic – ALS Coordinator**

There is one (1) employee to be covered under hazardous duty at this time. Attached is a copy of the Position Questionnaires and the Job Description.

The City of Edgewood has requested hazardous duty coverage for the following position with an effective date of May 1, 2013:

**Firefighter/Paramedic**

There are no employees to be covered under hazardous duty at this time. Attached is a copy of the Position Questionnaires and the Job Description.

**RECOMMENDATION:** The positions for which hazardous duty has been requested are presented for discussion.