

Financial Statements

KENTUCKY RETIREMENT SYSTEMS

June 30, 2006

KENTUCKY RETIREMENT SYSTEMS

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Kentucky Retirement Systems
Frankfort, Kentucky

We have audited the financial statements of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Kentucky Retirement Systems' management. Our responsibility is to express an opinion on these financial statements based on our audit.

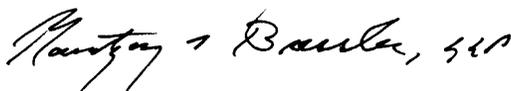
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and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

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of June 30, 2006 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 August 31, 2006 on our consideration of the Kentucky Retirement Systems' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis (pages 2 through 6) and the required supplementary information included in the schedule of funding progress and schedule of employer contributions (pages 31 through 39) are not a required part of the basic financial statements, but are supplementary information required by auditing standards generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional supporting schedules (pages 41 through 47) are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such 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.



August 31, 2006
Louisville, Kentucky

KENTUCKY RETIREMENT SYSTEMS

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

This discussion and analysis of Kentucky Retirement System's financial performance provides an overview of the pension and insurance fund financial activities for the fiscal year ended June 30, 2006. Please read it in conjunction with the financial statements, which begin on page 7.

FINANCIAL HIGHLIGHTS—PENSION FUND

The following highlights are explained in more detail later in this discussion.

- The combined plan net assets of all pension funds administered by Kentucky Retirement Systems increased by \$545 million during the 2005-2006 fiscal year.
- Covered payroll for 2005-2006 was \$4,348 million compared to covered payroll for the 2004-2005 plan year of \$4,160.4 million, increasing approximately \$187.6 million. The corresponding employer contributions increased by \$79.7 million for a total employer contribution amount of \$469.9 million. Of the total employer contribution amount, \$216.5 million was posted to the pension funds while \$253.4 million was posted to the insurance funds. Contributions paid by employees were \$275.9 and \$310.8 million respectively for the years ended June 30, 2006 and June 30, 2005. This decrease in employee contribution is a result of a decrease in service purchased by KRS members.
- The net appreciation in the fair value of investments was \$803.6 million for the year ended June 30, 2006 compared to net appreciation of \$723.8 million for the prior fiscal year. Included in this net appreciation were realized gains on sales of investments of \$601.6 million. In comparison, the pension funds realized gains of \$474.9 million for the year ended June 30, 2005. The increase in realized gain experienced by the pension funds is due to a favorable change in market conditions.
- Interest, dividend and securities lending income net of their respective expenses was \$358.8 million compared to \$335.3 million net investment income in last fiscal year.
- Pension benefits paid to retirees and beneficiaries increased \$102.1 million bringing total benefit payments to \$1,062.6 million. Refund of contributions paid to former members upon termination of employment increased from \$23.9 million to \$24.9 million.
- Administrative expense increased \$4.8 million totaling \$22.2 million compared to \$17.4 million in the prior year.

KENTUCKY RETIREMENT SYSTEMS

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

FINANCIAL HIGHLIGHTS—INSURANCE FUND

The following highlights are explained in more detail later in this discussion.

- The combined plan net assets of the insurance fund administered by Kentucky Retirement Systems increased by \$272 million during the 2005-2006 fiscal year.
- Premiums received from retirees that participated in the self-funded plan totaled \$12.3 million.
- Employer contributions of \$253.4 million were received. This is an increase of \$20.7 million over the prior fiscal year. This increase is due to the increase of covered payroll reported by participating employers.
- The net appreciation in the fair value of investments was \$188.2 million compared to net appreciation of \$122.1 million for the prior fiscal year. Included in this net appreciation were realized gains on sales of investments of \$77.9 million. In comparison, the insurance funds realized gains on investments of \$35.9 million in the prior fiscal year. This increase in realized gains is due to a favorable change in market conditions.
- Interest, dividend and securities lending income net of their respective expenses was approximately \$42 million compared to net investment income of approximately \$36 million in last fiscal year.
- Premiums paid by the fund for hospital and medical insurance coverage totaled \$177.5 million. Payments for the self-funded healthcare reimbursements totaled \$35.3 million. The total of insurance premiums paid plus self-funded reimbursements was \$212.8 million for the 2005-2006 plan year. Insurance premium paid for the prior plan year totaled \$166.9 million.

USING THIS FINANCIAL REPORT

This financial report consists of two financial statements and two required schedules of historical trend information. The Combining Statement of Plan Net Assets for the Pension Fund on page 7 and for the Insurance Fund on page 9 provides a snapshot of the financial position of the each of the three systems at June 30, 2006. The Combining Statement of Changes in Plan Net Assets for the Pension Fund on page 8 and for the Insurance Fund on page 10 summarize the additions and deductions that occurred for each of the three systems during the period from July 1, 2005 through June 30, 2006.

The Schedule of Funding Progress on pages 31-36 includes historical trend information about the actuarially funded status of each plan from a long-term, ongoing plan perspective and the progress made in accumulating sufficient assets to pay benefits and insurance premiums when due. The Schedule of Employer Contributions on pages 37-39 presents historical trend information about the annual required contributions of employers and the contributions made by employers in relation to the requirement. These schedules provide information that contributes to understanding the changes over time in the funded status of the plans.

KENTUCKY RETIREMENT SYSTEMS

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

KENTUCKY RETIREMENT SYSTEMS AS A WHOLE

Kentucky Retirement Systems' combined plan net assets increased during the year ended June 30, 2006 by approximately \$ 837 million from \$14,333.8 million to \$15,171.3 million. Plan net assets for the prior fiscal year increased by \$752.4 million. The increase in plan net assets for the plan year ended June 30, 2006 is primarily attributable to the gains on investment due to favorable market conditions. The analysis below focuses on plan net assets (Table 1) and changes in plan net assets (Table 2) of Kentucky Retirement Systems' pension funds and insurance fund.

Table 1
Plan Net Assets
(In Millions)

	Pension Funds			Insurance Fund			Total		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
Cash & Invest.	\$ 16,299.5	\$ 14,926.9	\$ 13,327.7	\$ 2,691.6	\$ 2,338.9	\$ 2,000.8	\$ 18,991.1	\$ 17,265.8	\$ 15,328.5
Receivables	\$ 123.4	\$ 123.4	\$ 123.3	\$ 35.7	\$ 23.5	\$ 21.4	\$ 159.1	\$ 146.9	\$ 144.7
Equip., net of dep.	\$ 1.3	\$ 0.8	\$ 0.9				\$ 1.3	\$ 0.8	\$ 0.9
Total Assets	\$ 16,424.2	\$ 15,051.1	\$ 13,451.9	\$ 2,727.3	\$ 2,362.4	\$ 2,022.2	\$ 19,151.5	\$ 17,413.5	\$ 15,474.1
Total Liabilities	\$ (3,474.0)	\$ (2,645.9)	\$ (1,572.3)	\$ (526.7)	\$ (433.8)	\$ (320.4)	\$ (4,000.7)	\$ (3,079.7)	\$ (1,892.7)
Plan Net Assets	\$ 12,950.2	\$ 12,405.2	\$ 11,879.6	\$ 2,200.6	\$ 1,928.6	\$ 1,701.8	\$ 15,150.8	\$ 14,333.8	\$ 13,581.4

Table 2
Changes in Plan Net Assets
(In Millions)

	Pension Funds			Insurance Fund			Total		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
Additions:									
Member Cont.	\$ 275.9	\$ 310.8	\$ 306.7				\$ 275.9	\$ 310.8	\$ 306.7
Employer Cont.	\$ 216.5	\$ 157.5	\$ 104.3	\$ 253.4	\$ 232.7	\$ 237.8	\$ 469.9	\$ 390.2	\$ 342.1
Premiums Rec'd				\$ 12.3			\$ 12.3		
Insurance Approp				\$ 11.8	\$ 4.6		\$ 11.8	\$ 4.6	
Invest. Inc. (net)	\$ 1,162.4	\$ 1,059.1	\$ 1,442.9	\$ 230.8	\$ 157.6	\$ 253.1	\$ 1,393.2	\$ 1,216.7	\$ 1,696.0
Total additions	\$ 1,654.8	\$ 1,527.4	\$ 1,853.9	\$ 508.3	\$ 394.9	\$ 490.9	\$ 2,163.1	\$ 1,922.3	\$ 2,344.8
Deductions:									
Benefit payments	\$ 1,062.6	\$ 960.5	\$ 849.2				\$ 1,062.6	\$ 960.5	\$ 849.2
Refunds	\$ 24.9	\$ 23.9	\$ 23.4				\$ 24.9	\$ 23.9	\$ 23.4
Administrative Ex.	\$ 22.3	\$ 17.4	\$ 15.2	\$ 3.6	\$ 1.2	\$ 1.0	\$ 25.9	\$ 18.6	\$ 16.2
Healthcare Costs				\$ 212.8	\$ 166.9	\$ 131.9	\$ 212.8	\$ 166.9	\$ 131.9
Demut. Refund				\$ 20.0			\$ 20.0		
Total deductions	\$ 1,109.8	\$ 1,001.8	\$ 887.8	\$ 236.4	\$ 168.1	\$ 132.9	\$ 1,346.2	\$ 1,169.9	\$ 1,020.7
Inc. (decrease) in plan net assets	\$ 545.0	\$ 525.6	\$ 966.1	\$ 271.9	\$ 226.8	\$ 358.0	\$ 816.9	\$ 752.4	\$ 1,324.1

Plan net assets of the pension funds increased by \$545 million (\$12,950.2 million compared to \$12,405.2 million). All of these assets are restricted in use to provide monthly retirement allowances to members who contributed to the pension funds as employees and their beneficiaries. This plan net asset increase is attributable primarily to the net appreciation in the fair value of investments due to the change in market conditions in general.

Plan net assets of the insurance fund increased by approximately \$272 million (\$2,200.6 million compared to \$1,928.6 million). All of these assets are restricted in use to provide hospital and medical insurance benefits to members of the pension funds who receive a monthly retirement allowance. This increase in net plan assets is primarily attributable to the net appreciation in the fair value of investments, which is due to the change in market conditions in general.

KENTUCKY RETIREMENT SYSTEMS

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

PENSION FUND ACTIVITIES

Member contributions decreased by \$34.9 million. Retirement contributions are calculated by applying a percentage factor to salary and are remitted by each employer on behalf of the member. Members may also pay contributions to repurchase previously refunded service credit or to purchase various types of elective service credit. The decrease in member contributions is a result of a decrease in elective service purchases by KRS members.

Employer contributions increased by \$59 million due to the increase in covered payroll reported to KRS and the increase in the contribution rates applied to the pension funds.

Net investment income increased by \$103 million (net investment income of \$1,162 million compared to net investment income of \$1,059 million in the prior year). The pension funds experienced an increase in income primarily due to the increase in gains on sale of investments. This can be illustrated in Table 3 as follows:

Investment Income (Pension)	In Millions		
	2006	2005	2004
Appreciation in fair value of investments current year end	\$ 1,845	\$ 1,644	\$ 1,395
Appreciation in fair value of investments prior year end	\$ 1,644	\$ 1,395	\$ 478
Net appreciation in fair value of investments	\$ 201	\$ 249	\$ 917
Investment Income net of Investment Expense	\$ 359	\$ 335	\$ 298
Gain (loss) on sale of investments	\$ 602	\$ 475	\$ 228
Investment Income (net)	\$ 1,162	\$ 1,059	\$ 1,443

Pension fund deductions increased by \$108 million caused principally by an increase of \$102.1 million in benefit payments. Retirees received an increase of 2.7% in benefit payments as of July 1, 2005. Refunds of member contributions increased by \$1 million.

INSURANCE FUND ACTIVITIES

Employer contributions paid into the insurance fund increased by \$20.7 million over the prior year. This increase is a result of the increase in covered payroll reported to KRS.

Net investment income increased by approximately \$73 million. This increase in net income is due primarily to the increase in the gains on sale of investments. This can be illustrated in Table 4 as follows:

Investment Income (Insurance)	In Millions		
	2006	2005	2004
Appreciation in fair value of investments current year end	\$ 415	\$ 304	\$ 218
Appreciation in fair value of investments prior year end	\$ 304	\$ 218	\$ 11
Net appreciation in fair value of investments	\$ 111	\$ 86	\$ 207
Investment Income net of Investment Expense	\$ 42	\$ 36	\$ 24
Gain (loss) on sale of investments	\$ 78	\$ 36	\$ 22

Insurance fund deductions increased by \$68.3 million primarily due to the increase in healthcare costs.

KENTUCKY RETIREMENT SYSTEMS

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006

HISTORICAL TRENDS

Accounting standards require that the statement of plan net assets state asset value at **fair value** and include only benefits and refunds due plan members and beneficiaries and accrued investment and administrative expense as of the reporting date. Information regarding the actuarial funding status of the pension funds and insurance fund is provided in the Schedule of Funding Progress on pages 31-36. The asset value stated in the Schedule of Funding Progress is the **actuarial value** of assets determined by calculating the difference between the expected valuation assets and the actual market value of assets adjusted for any unrecognized gains or losses and amortized over a five-year period. The actuarial accrued liability is calculated using the entry age normal cost funding method. The difference in value between the actuarial accrued liability and the actuarial value of assets is known as the unfunded actuarial accrued liability. This unfunded actuarial accrued liability is the measure of the cost of benefits that have been earned to date by KRS members, but not yet paid for.

The unfunded actuarial accrued liability in the pension plans increased by \$2,567 million for a total unfunded amount of \$5,375.6 million for the year ended June 30, 2006 compared to an unfunded amount of \$2,808.6 for the year-end June 30, 2005. In recent years, funding levels for the pension funds have fallen dramatically in response to investment returns less than the actuarially assumed rate, higher than anticipated retirement rates, the 2006 assumption changes, and increasing expenditures for retiree Cost of Living Adjustments. Within the KERS and SPRS plans, employer contribution rate reductions enacted by the State Legislature have limited the plans ability to correct the declining funding levels.

The post-employment healthcare plans continue to have a large unfunded actuarial accrued liability increasing to \$13,424.7 million for the plan year ended June 30, 2006 from \$5,455.3 million for the plan year ended June 30, 2005. This is an increase in the unfunded amount of \$7,969.4 million. While the funding level relative to the insurance funds has improved steadily since 1990, medical inflation rates in excess of the assumed rates as well as recent employer contribution rate reductions under KERS and SPRS have significantly limited this improvement. The recent adoption of new actuarial assumptions and the application of GASB Statement 43 requirements have further reduced the measured funding level.

Annual required contributions of the employers as actuarially determined and actual contributions made by the employers in relation to the required contributions are provided in the Schedule of Employer Contributions on pages 37-39. The difference in the annual required contributions and actual contributions made by employers in the KERS and SPRS funds is attributable to the statutory employer contribution rate set by the Kentucky General Assembly being less than the rate computed by the actuary.

KENTUCKY RETIREMENT SYSTEMS

COMBINED STATEMENT OF PLAN NET ASSETS--PENSION FUNDS

As of June 30, 2006 (with Comparative Totals as of June 30, 2005)

(Dollars in Thousands)

	2006			2005	
	KERS	CERS	SPRS	Total	Total
ASSETS					
Cash and short-term investments					
Cash	\$ 1,966	\$ 954	\$ 90	\$ 3,010	\$ 1,499
Short-term investments	<u>120,777</u>	<u>108,000</u>	<u>12,110</u>	<u>240,887</u>	<u>353,055</u>
Total cash and short-term investments	122,743	108,954	12,200	243,897	354,554
Receivables					
Contributions	24,891	38,715	1,290	64,896	66,599
Investment income	<u>25,842</u>	<u>31,070</u>	<u>1,572</u>	<u>58,484</u>	<u>56,760</u>
Total receivables	50,733	69,785	2,862	123,380	123,359
Investments, at fair value					
Corporate and government bonds	1,685,307	2,045,088	105,004	3,835,399	3,955,223
Corporate stocks	3,686,132	4,011,783	211,565	7,909,480	7,329,933
Mortgages	334,067	490,536	20,933	845,536	641,949
Real estate	<u>4,289</u>	<u>4,775</u>	<u>481</u>	<u>9,545</u>	<u>9,693</u>
Total investments at fair value	5,709,795	6,552,182	337,983	12,599,960	11,936,798
Securities lending collateral invested	1,254,181	2,093,411	108,101	3,455,693	2,635,518
Equipment (net of accumulated depreciation)	<u>473</u>	<u>796</u>	<u>8</u>	<u>1,277</u>	<u>832</u>
Total Assets	<u>7,137,925</u>	<u>8,825,128</u>	<u>461,154</u>	<u>16,424,207</u>	<u>15,051,061</u>
LIABILITIES					
Accounts payable	6,581	11,495	212	18,288	10,352
Securities lending collateral	<u>1,254,181</u>	<u>2,093,411</u>	<u>108,101</u>	<u>3,455,693</u>	<u>2,635,518</u>
Total Liabilities	<u>1,260,762</u>	<u>2,104,906</u>	<u>108,313</u>	<u>3,473,981</u>	<u>2,645,870</u>
Plan Net Assets Held in Trust for Pension Benefits	<u>\$ 5,877,163</u>	<u>\$ 6,720,222</u>	<u>\$ 352,841</u>	<u>\$ 12,950,226</u>	<u>\$ 12,405,191</u>

(A schedule of funding progress for each plan is presented on pages 30-36)

See accompanying independent auditor's report and notes to financial statements

KENTUCKY RETIREMENT SYSTEMS

COMBINED STATEMENT OF CHANGES IN PLAN NET ASSETS--PENSION FUNDS

For The Year Ended June 30, 2006 (with Comparative Totals for the Year Ended June 30, 2005)

(Dollars in Thousands)

	2006			2005	
	KERS	CERS	SPRS	Total	Total
ADDITIONS					
Members' contributions	\$ 119,663	\$ 151,427	\$ 4,814	\$ 275,904	\$ 310,806
Employers' contributions	<u>71,484</u>	<u>140,810</u>	<u>4,244</u>	<u>216,538</u>	<u>157,508</u>
Total contributions	191,147	292,237	9,058	492,442	468,314
INVESTMENT INCOME					
From investing activities					
Net appreciation in fair value of investments	385,613	388,362	29,621	803,596	723,831
Interest/Dividends	<u>166,041</u>	<u>193,992</u>	<u>9,976</u>	<u>370,009</u>	<u>344,929</u>
Total investing activities income	551,654	582,354	39,597	1,173,605	1,068,760
Investment expense	4,818	5,509	284	10,611	10,138
Commissions	<u>3,728</u>	<u>4,262</u>	<u>222</u>	<u>8,212</u>	<u>5,818</u>
Total investing activities expense	<u>8,546</u>	<u>9,771</u>	<u>506</u>	<u>18,823</u>	<u>15,956</u>
Net income from investing activities	<u>543,108</u>	<u>572,583</u>	<u>39,091</u>	<u>1,154,782</u>	<u>1,052,804</u>
From Securities Lending Activities					
Securities lending income	49,082	81,454	4,234	134,770	55,872
Securities lending expense:					
Security borrower rebates	45,255	75,538	3,901	124,694	47,836
Security lending agent fees	<u>894</u>	<u>1,492</u>	<u>77</u>	<u>2,463</u>	<u>1,745</u>
Net income from securities lending activities	<u>2,933</u>	<u>4,424</u>	<u>256</u>	<u>7,613</u>	<u>6,291</u>
Total net investment income	<u>546,041</u>	<u>577,007</u>	<u>39,347</u>	<u>1,162,395</u>	<u>1,059,095</u>
Total Additions	737,188	869,244	48,405	1,654,837	1,527,409

	2006			2005	
	KERS	CERS	SPRS	Total	Total
DEDUCTIONS					
Benefit payments	\$ 601,683	\$ 426,222	\$ 34,703	\$ 1,062,608	\$ 960,521
Refunds	11,068	13,736	133	24,937	23,896
Administrative expenses	<u>8,213</u>	<u>13,910</u>	<u>134</u>	<u>22,257</u>	<u>17,432</u>
Total deductions	<u>620,964</u>	<u>453,868</u>	<u>34,970</u>	<u>1,109,802</u>	<u>1,001,849</u>
Net increase in plan assets	116,224	415,376	13,435	545,035	525,560
Plan net assets held in trust for Pension Benefits					
Beginning of Year	<u>5,760,939</u>	<u>6,304,846</u>	<u>339,406</u>	<u>12,405,191</u>	<u>11,879,631</u>
End of Year	<u>\$ 5,877,163</u>	<u>\$ 6,720,222</u>	<u>\$ 352,841</u>	<u>\$ 12,950,226</u>	<u>\$ 12,405,191</u>

See accompanying independent auditor's report and notes to financial statements

KENTUCKY RETIREMENT SYSTEMS

COMBINED STATEMENT OF PLAN NET ASSETS—INSURANCE FUNDS

As of June 30, 2006 (with Comparative Totals as of June 30, 2005)
(Dollars in Thousands)

	2006			2005	
	KERS	CERS	SPRS	Total	Total
ASSETS					
Cash and short-term investments					
Cash	\$ 133	\$ 125	\$ 7	\$ 265	\$ 207
Short-term investments	<u>120,317</u>	<u>104,467</u>	<u>9,066</u>	<u>233,850</u>	<u>210,072</u>
Total cash and short-term investments	120,450	104,592	9,073	234,115	210,279
Receivables					
Contributions	4,751	25,164	378	30,293	18,617
Investment income	<u>2,131</u>	<u>3,042</u>	<u>267</u>	<u>5,440</u>	<u>4,909</u>
Total receivables	6,882	28,206	645	35,733	23,526
Investments, at fair value					
Corporate and government bonds	82,777	127,316	10,689	220,782	199,189
Corporate stocks	647,671	997,385	90,208	1,735,264	1,497,841
Alternative Investment	<u>30</u>	<u>98</u>	<u>7</u>	<u>135</u>	
Total investments	730,478	1,124,799	100,904	1,956,181	1,697,030
Security lending collateral invested	<u>131,343</u>	<u>344,439</u>	<u>25,561</u>	<u>501,343</u>	<u>431,552</u>
Total Assets	<u>989,153</u>	<u>1,602,036</u>	<u>136,183</u>	<u>2,727,372</u>	<u>2,362,387</u>
LIABILITIES					
Accounts payable	1,767	3,478	162	5,407	2,230
Demutualization proceeds payable	20,000			20,000	
Securities lending collateral obligations	<u>131,343</u>	<u>344,439</u>	<u>25,561</u>	<u>501,343</u>	<u>431,552</u>
Total Liabilities	<u>153,110</u>	<u>347,917</u>	<u>25,723</u>	<u>526,750</u>	<u>433,782</u>
Plan Net Assets Held in Trust for Insurance Benefits	<u>\$ 836,043</u>	<u>\$ 1,254,119</u>	<u>\$ 110,460</u>	<u>\$ 2,200,622</u>	<u>\$ 1,928,605</u>

(A schedule of funding progress for each plan is presented on pages 30-35)

See accompanying independent auditor's report and notes to financial statements

KENTUCKY RETIREMENT SYSTEMS

COMBINED STATEMENT OF CHANGES IN PLAN NET ASSETS—INSURANCE FUNDS

For The Year Ended June 30, 2006 (with Comparative Totals for the Year Ended June 30, 2005)

(Dollars in Thousands)

	2006			2005	
	KERS	CERS	SPRS	Total	Total
ADDITIONS					
Employers' contributions	\$ 59,992	\$ 187,415	\$ 5,990	\$ 253,397	\$ 232,681
Insurance appropriation	4,655	6,307	890	11,852	4,562
Premiums received from retirees	<u>5,858</u>	<u>6,463</u>	<u>5</u>	<u>12,326</u>	
Total contributions	70,505	200,185	6,885	277,575	237,243
INVESTMENT INCOME					
From investing activities:					
Net appreciation in fair value of investments	73,309	105,015	9,907	188,231	122,126
Interest/Dividends	<u>17,019</u>	<u>24,360</u>	<u>2,204</u>	<u>43,583</u>	<u>36,400</u>
Total income from investing activities	90,328	129,375	12,111	231,814	158,526
Investment activities expense	655	1,133	101	1,889	1,428
Commissions	<u>223</u>	<u>313</u>	<u>31</u>	<u>567</u>	<u>563</u>
Total investing activities expense	<u>878</u>	<u>1,446</u>	<u>132</u>	<u>2,456</u>	<u>1,991</u>
Net income from investing activities	<u>89,450</u>	<u>127,929</u>	<u>11,979</u>	<u>229,358</u>	<u>156,535</u>
From Securities Lending Activities					
Securities lending income	5,806	15,163	1,125	22,094	9,039
Securities lending expense:					
Security borrower rebates	5,316	13,943	1,035	20,294	7,669
Security lending agent fees	<u>96</u>	<u>252</u>	<u>18</u>	<u>366</u>	<u>262</u>
Net income from securities lending activities	<u>394</u>	<u>968</u>	<u>72</u>	<u>1,434</u>	<u>1,108</u>
Total net investment income	<u>89,844</u>	<u>128,897</u>	<u>12,051</u>	<u>230,792</u>	<u>157,643</u>
Total Additions	160,349	329,082	18,936	508,367	394,886

	2006			2005	
	KERS	CERS	SPRS	Total	Total
DEDUCTIONS					
Healthcare premiums subsidies	\$ 84,526	\$ 85,699	\$ 7,252	\$ 177,477	\$ 166,892
Administrative fees	1,742	1,752	68	3,562	1,231
Self funding insurance costs	17,810	16,937	564	35,311	
Demutualization proceeds refunded	<u>20,000</u>			<u>20,000</u>	
Total deductions	<u>124,078</u>	<u>104,388</u>	<u>7,884</u>	<u>236,350</u>	<u>168,123</u>
Net increase in plan assets	36,271	224,694	11,052	272,017	226,763
Plan net assets held in trust for insurance benefits					
Beginning of Year	<u>799,772</u>	<u>1,029,425</u>	<u>99,408</u>	<u>1,928,605</u>	<u>1,701,842</u>
End of Year	<u>\$ 836,043</u>	<u>\$ 1,254,119</u>	<u>\$ 110,460</u>	<u>\$ 2,200,622</u>	<u>\$ 1,928,605</u>

See accompanying independent auditor's report and notes to financial statements

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Under the provisions of Kentucky Revised Statute Section 61.645, the Board of Trustees of Kentucky Retirement Systems (KRS) administers the Kentucky Employees Retirement System (KERS), County Employees Retirement System (CERS), and State Police Retirement System (SPRS). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to the members of that plan, in accordance with the provisions of Kentucky Revised Statute Sections 16.555, 61.570, and 78.630.

Under the provisions of Kentucky Revised Statute Section 61.701, the Board of Trustees of Kentucky Retirement Systems (KRS) administers the Kentucky Retirement Systems Insurance Fund. The statutes provide for a single insurance fund to provide group hospital and medical benefits to retirees drawing a benefit from the three pension funds administered by Kentucky Retirement Systems: (1) Kentucky Employees Retirement System (KERS); (2) County Employees Retirement System (CERS); and (3) State Police Retirement System (SPRS). The assets of the various insurance funds are commingled for investment purposes. The following notes apply to the various funds administered by Kentucky Retirement Systems.

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - KRS financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the Plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with terms of the Plan. Premium payments are recognized when due and payable in accordance with terms of the Plan.

Method Used to Value Investments - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate is based on appraisals. Investments that do not have an established market are reported at estimated fair value.

Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Equipment - Equipment is valued at historical cost and depreciation is computed utilizing the straight-line method over the estimated useful lives of the assets ranging from three to ten years.

Expense Allocation - Administrative and investment expenses of the Kentucky Retirement Systems are allocated in proportion to the number of active members participating in each plan and the carrying value of plan investments, respectively.

Component Unit - Kentucky Retirement Systems is a component unit of the Commonwealth of Kentucky for financial reporting purposes.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--CONTINUED

The Kentucky Employees Retirement System (KERS) was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 61.515. The County Employees Retirement System (CERS) was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 78.520. The State Police Retirement System (SPRS) was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 16.510. The Kentucky Retirement Systems Insurance Fund consisting of the Kentucky Employees Insurance Fund, Kentucky Employee Hazardous Insurance Fund, County Employees Insurance Fund, County Employees Hazardous Insurance Fund and State Police Insurance Fund was created by the Kentucky General Assembly pursuant to the provisions of Kentucky Revised Statute 61.701. KRS' administrative budget is subject to approval by the Kentucky General Assembly. Employer contribution rates for KERS and SPRS are also subject to legislative approval. Employer contribution rates for CERS are determined by the Systems' Board of Trustees without further legislative review. The methods used to determine the employer rates for all Retirement Systems are specified in Kentucky Revised Statute 61.565. Employee contribution rates are set by statute and may be changed only by the Kentucky General Assembly.

NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

Membership of each Retirement plan consisted of the following at June 30, 2006 and 2005:

	KENTUCKY EMPLOYEES RETIREMENT SYSTEM					
	2006			2005		
	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
<u>Number of Members</u>						
Retirees and beneficiaries receiving benefits	32,140	1,980	34,120	30,770	1,752	32,522
Inactive Vested Retirements	4,998	265	5,263	5,240	307	5,547
Inactive Vested Memberships	24,145	2,236	26,381	23,105	1,997	25,102
Active plan members	<u>46,707</u>	<u>4,320</u>	<u>51,027</u>	<u>47,118</u>	<u>4,274</u>	<u>51,392</u>
Total	<u>107,990</u>	<u>8,801</u>	<u>116,791</u>	<u>106,233</u>	<u>8,330</u>	<u>114,563</u>
Number of participating employers			<u>353</u>			<u>350</u>

	COUNTY EMPLOYEES RETIREMENT SYSTEM					
	2006			2005		
	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
<u>Number of Members</u>						
Retirees and beneficiaries receiving benefits	33,102	4,712	37,814	31,347	4,361	35,708
Inactive Vested Retirements	7,379	393	7,772	7,771	482	8,253
Inactive Vested Memberships	42,667	1,562	44,229	41,098	1,489	42,587
Active plan members	<u>83,694</u>	<u>9,635</u>	<u>93,329</u>	<u>81,240</u>	<u>9,464</u>	<u>90,704</u>
Total	<u>166,842</u>	<u>16,302</u>	<u>183,144</u>	<u>161,456</u>	<u>15,796</u>	<u>177,252</u>
Number of participating employers			<u>1,391</u>			<u>1,400</u>

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED

STATE POLICE RETIREMENT SYSTEM

	<u>2006</u>	<u>2005</u>
	Hazardous Position Employees	Hazardous Position Employees
<u>Number of Members</u>		
Retirees and beneficiaries receiving benefits	1,067	1,036
Inactive Vested Retirements	48	42
Inactive Vested Memberships	218	210
Active plan members	<u>1,028</u>	<u>987</u>
Total	<u>2,361</u>	<u>2,275</u>
Number of participating employers	<u>1</u>	<u>1</u>

KENTUCKY RETIREMENT SYSTEMS INSURANCE FUNDS

Hospital and medical contracts in force consisted of the following at June 30, 2006 and 2005:

	<u>2006</u>					<u>2005</u>				
	<u>Single</u>	<u>Couple/ Family</u>	<u>Parent</u>	<u>Medicare Without Prescription</u>	<u>Medicare With Prescription</u>	<u>Single</u>	<u>Couple/ Family</u>	<u>Parent+</u>	<u>Medicare Without Prescription</u>	<u>Medicare With Prescription</u>
KERS Non-Hazardous	8,393	1,826	490	1,672	12,000	7,928	1,679	461	1,915	11,764
KERS Hazardous	656	378	58	74	603	570	319	65	61	567
CERS Non-Hazardous	6,298	1,058	249	2,502	11,803	6,014	1,022	255	2,853	11,005
CERS Hazardous	1,275	1,739	198	52	1,105	1,220	1,579	195	55	1,004
SPRS	<u>260</u>	<u>406</u>	<u>29</u>	<u>9</u>	<u>368</u>	<u>257</u>	<u>388</u>	<u>34</u>	<u>10</u>	<u>348</u>
Totals	<u>16,882</u>	<u>5,407</u>	<u>1,024</u>	<u>4,309</u>	<u>25,879</u>	<u>15,989</u>	<u>4,987</u>	<u>1,010</u>	<u>4,894</u>	<u>24,688</u>

KENTUCKY EMPLOYEES RETIREMENT SYSTEM

Non-Hazardous Employees Pension Plan

Plan Description - KERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of any state department, board, or agency directed by Executive Order to participate in the System. The Plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent in any plan year. The General Assembly reserves the right to suspend or reduce cost-of-living adjustments if in its judgment the welfare of the Commonwealth so demands.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED

Contributions - For the years ended June 30, 2006 and 2005, plan members were required to contribute 5% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the years ended June 30, 2006 and 2005, participating employers contributed 5.89% of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2006 and 2005 was 13.62% and 10.29%, respectively, of each employee's creditable compensation. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

Hazardous Employees Pension Plan

Plan Description - KERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in hazardous duty positions of any state department, board, or agency directed by Executive Order to participate in the System. The Plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent in any plan year. The General Assembly reserves the right to suspend or reduce cost-of-living adjustments if in its judgment the welfare of the Commonwealth so demands.

Contributions - For the years ended June 30, 2006 and 2005, plan members were required to contribute 8% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the years ended June 30, 2006 and 2005, participating employers contributed 18.84% of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2006 and 2005 was 21.59% and 19.47%, respectively, of each employee's creditable compensation. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED

COUNTY EMPLOYEES RETIREMENT SYSTEM

Non-Hazardous Employees Pension Plan

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The Plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided at the discretion of the State legislature.

Contributions - For the years ended June 30, 2006 and 2005, plan members were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the years ended June 30, 2006 and 2005, participating employers contributed 10.98% and 8.48%, respectively, of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2006 and 2005 was 10.98% and 8.48%, respectively. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

Hazardous Employees Pension Plan

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The Plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided at the discretion of the State legislature.

Contributions - For the years ended June 30, 2006 and 2005, plan members were required to contribute 8% of their annual creditable compensation. The participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the years ended June 30, 2006 and 2005, participating employers contributed 28.21% and 22.08%, respectively, of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2006 and 2005 was 25.01% and 22.08%, respectively, of each employee's creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED

STATE POLICE RETIREMENT SYSTEM

Plan Description - SPRS is a single-employer defined benefit pension plan that covers all full-time state troopers employed in a hazardous duty position by the Kentucky State Police. The Plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living adjustments (COLA) are provided at the discretion of the State legislature.

Contributions - For the years ended June 30, 2006 and 2005 plan members were required to contribute 8% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the years ended June 30, 2006 and 2005, the Commonwealth contributed 21.58% of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2006 and 2005 was 34.83% and 28.08%, respectively, of each employee's creditable compensation. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

KENTUCKY RETIREMENT SYSTEMS INSURANCE FUNDS

Plan Description - The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System. The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. For fiscal 2006, insurance premiums withheld from benefit payments to members of KRS were \$23,925,504 and \$697,822 for KERS and KERS hazardous, respectively, \$23,353,491 and \$1,392,261 for CERS and CERS hazardous, respectively, and \$203,189 for SPRS. For fiscal year ending 2005, insurance premiums withheld from benefit payments to members of the Systems were \$25,491,575 and \$781,396 for KERS and KERS hazardous, respectively, \$23,110,726 and \$1,983,786 for CERS and CERS hazardous, respectively, and \$494,223 for SPRS. The Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous members killed in the line of duty. As of June 30, 2006 the Fund had 73,001 retirees and beneficiaries for whom benefits were available.

The amount of contribution paid by the Funds is based on years of service. For members participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

<u>Years of Service</u>	<u>% Paid by Insurance Fund</u>
20 or More	100%
15 - 19	75%
10 - 14	50%
4 - 9	25%
Less Than 4	0%

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participating on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003 earn ten dollars (\$10) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Hazardous employees whose participation began on or after July 1, 2003 earn fifteen dollars (\$15) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Upon death of a hazardous employee, such employee's spouse receives ten dollars (\$10) per month for insurance benefits for each year of the deceased employee's earned hazardous service. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment (COLA), which is updated annually due to changes in the Consumer Price Index for all urban consumers. This benefit is not protected under the inviolable contract provisions of Kentucky Revised Statute 16.652, 61.692 and 78.852. The General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

In prior years, the employers' required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20-year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed. In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years.

Kentucky Retirement Systems commenced self-funding of healthcare benefits for its medicare eligible retirees on January 1, 2006. A self-funded plan is one in which Kentucky Retirement Systems assumes the financial risk for providing healthcare benefits to its retirees. The self-funded plan pays for claims out-of-pocket as they are presented instead of paying a pre-determined premium to an insurance carrier for a fully-insured plan. Kentucky Retirement Systems funds the risk directly from its assets. Kentucky Retirement Systems becomes directly responsible for administering benefits under the plan.

Kentucky Retirement Systems' plan is defined by statute. Kentucky Retirement Systems selected Walgreens Health Initiatives and Fiserv Health (Wausau Benefits, Inc.) to administer the pharmaceutical and medical benefits for its retirees.

Stop-loss insurance can be arranged to limit the Kentucky Retirement Systems' loss to a specified amount to ensure that catastrophic claims do not upset the financial integrity of the self-funded plan. The amount of stop-loss insurance is a function of Kentucky Retirement Systems' size, nature of its business, financials, and tolerance for risk. Kentucky Retirement Systems is in the process of evaluating the use of stop-loss insurance.

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE C--CASH AND SHORT-TERM INVESTMENTS AND SECURITIES LENDING COLLATERAL

The provisions of Governmental Accounting Standards Board Statement No. 28, "Accounting and Financial Reporting for Securities Lending Transactions" require that cash received as collateral on securities lending transactions and investments made with that cash be reported as assets on the financial statements. In conjunction with the adoption of Governmental Accounting Standard No. 28, KRS has reclassified certain other investments, not related to the securities lending program, as short-term. Cash and short-term investments consist of the following:

KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	<u>2006</u>	<u>2005</u>
Cash	\$ 1,965,448	\$ 726,023
Short-Term Investments	120,776,512	118,148,292
Securities Lending Collateral Invested	<u>1,254,181,656</u>	<u>1,225,388,483</u>
Total	<u>\$1,376,923,616</u>	<u>\$ 1,344,262,798</u>

COUNTY EMPLOYEES RETIREMENT SYSTEM

	<u>2006</u>	<u>2005</u>
Cash	\$ 953,952	\$ 665,927
Short-Term Investments	108,000,545	240,737,425
Securities Lending Collateral Invested	<u>2,093,410,581</u>	<u>1,337,960,409</u>
Total	<u>\$2,202,365,078</u>	<u>\$ 1,579,363,761</u>

STATE POLICE RETIREMENT SYSTEM

	<u>2006</u>	<u>2005</u>
Cash	\$ 89,840	\$ 106,821
Short-Term Investments	12,110,352	(5,830,993)
Securities Lending Collateral Invested	<u>108,100,996</u>	<u>72,168,911</u>
Total	<u>\$ 120,301,188</u>	<u>\$ 66,444,739</u>

KENTUCKY RETIREMENT SYSTEMS INSURANCE FUNDS

	<u>2006</u>	<u>2005</u>
Cash	\$ 265,217	\$ 207,089
Short-Term Investments	233,849,473	210,072,016
Securities Lending Collateral Invested	<u>501,343,495</u>	<u>431,551,814</u>
Total	<u>\$ 735,458,185</u>	<u>\$ 641,830,919</u>

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS

The Board of Trustees of the Kentucky Retirement Systems (KRS) recognize their duty to invest funds in accordance with the Prudent Person Rule and manage those funds consistent with the long-term nature of KRS. The Board enters into contracts with investment managers who use the following guidelines and restrictions in the selection and timing of transactions as long as the security is not prohibited by the Kentucky Revised Statutes.

Equity Investments - Investments may be made in domestic and international common stock, securities convertible into common stock and in preferred stock of publicly traded corporations.

Fixed Income Investments - Publicly traded corporate bonds are to be selected and managed to assure an appropriate balance in quality and maturities consistent with the current market and economic conditions. Investment may also be made in any debt instrument issued or guaranteed in whole or in part by the U.S. Government or any agency or instrumentality of the U.S. Government.

Mortgages - Investment may be made in real estate mortgages on a direct basis or in the form of mortgage pool instruments guaranteed by an agency of the U.S. Government or the Commonwealth of Kentucky.

Alternative Investments/Equity Real Estate - Subject to the specific approval of the investment committee of the Board of Trustees, investments may be made for the purpose of creating a diversified portfolio of alternative investments. The Board may invest in real estate or alternative investments including, without limitation, venture capital, private equity and private placements which the investment committee believes has excellent potential to generate income and which may have a higher degree of risk.

Cash Equivalent Securities - The following short-term investment vehicles are considered acceptable:

Publicly traded investment grade corporate bonds, government and agency bonds, mortgages, and collective STIF's, money market funds or instruments (including, but not limited to, certificates of deposit, bank notes, deposit notes, bankers' acceptances and commercial paper) and repurchase agreements relating to the above instruments. Instruments may be selected from among those having a BBB or better rating by at least one recognized bond rating service. All instruments shall have a maturity at the time of purchase that does not exceed two years. Repurchase agreements shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur.

Derivatives - Investments may be made in derivative securities, or strategies which make use of derivative instruments, only if such investments do not cause the portfolio to be in any way leveraged beyond a 100% invested position. Investments in derivative securities which are subject to large or unanticipated changes in duration or cash flow, such as interest only (IO), principal only (PO), inverse floater, or structured note securities are expressly prohibited.

The Pension and Insurance Funds invest in collateralized mortgage obligations (CMOs) and other asset-backed securities to increase return and adjust duration of the portfolio. The Pension and Insurance Funds invest in exchange-traded funds to convert cash held in index funds to short-term equity investments. This practice is intended to make the performance of the index funds more closely track the performance of the index that the funds are intended to replicate.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS--CONTINUED

Collateralized mortgage obligations, asset-backed securities, and exchange-traded funds pose no greater risk than other similar investment grade holdings in the Systems' and the Fund's portfolios. The fair value of CMOs at June 30, 2006 and 2005 was approximately \$225 million and \$82 million respectively; the fair value of asset-backed securities at June 30, 2006 and 2005 was approximately \$195 million and \$252 million respectively; and the fair value of exchange-traded funds at June 30, 2006 and 2005 was approximately \$328 million and \$318 million, respectively.

Custodial Credit Risk for Deposits - Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the System's deposits may not be returned. All non-investment related bank balances are held locally by Farmers Bank & Capital Trust Company. All non-investment related bank balances are held in KRS' name and each individual account is insured up to \$100,000. These cash balances are invested daily by the local institution in overnight repurchase agreements which are required by Kentucky Administrative Regulation (200 KAR 14:081) to be collateralized at 102% of the principal amount.

At June 30, 2006 and 2005, deposits for KRS pension funds were \$4,175,409 and \$1,498,771, respectively. None of these balances were exposed to custodial credit risk as they were either insured or collateralized at required levels.

At June 30, 2006 and 2005, deposits for KRS insurance funds were \$242,866 and \$207,089, respectively. None of these balances were exposed to custodial credit risk as they were either insured or collateralized at required levels.

Custodial Credit Risk for Investments - Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to a transaction, KRS will not be able to recover the value of investments or collateral securities that are in the possession of an outside third party. Qualified Investment Managers, Custody Banks, Investment Consultants and other service providers are selected by the Investment Committee or Chief Investment Officer as required. The selection is based upon the demonstrated ability of the professional, or professionals, to provide the required expertise or assistance. At June 30 2006 and 2005, the following investments were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the System's name.

Pension Funds	<u>2006</u>	<u>2005</u>
Foreign Currency Investments	\$ 4,747,304	\$ 3,059,869
Insurance Funds		
Foreign Currency Investments	\$ 25,598	\$ 124,692

Investment Policies - Kentucky Revised Statute 61.650 grants the responsibility for the investment of plan assets to the Board of Trustees of the Kentucky Retirement Systems. The Board of Trustees has established an Investment Committee which is specifically charged with the oversight and investment of plan assets. The Investment Committee recognizes their duty to invest the funds in accordance with the Prudent Person Rule and manage those funds consistent with the long-term nature of the Systems. The Committee has adopted a Statement of Investment Policy that contains guidelines and restrictions for deposits and investments. By statute, all investments are to be registered and held in the name of the Kentucky Retirement Systems. The Statement of Investment Policy – Pension contains the specific guidelines for the investment of pension assets. The Statement of Investment Policy – Insurance contains the specific guidelines for the investment of insurance assets. Additionally, the Committee establishes specific investment guidelines in the Investment Management Agreement for each investment management firm.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS--CONTINUED

Investment Summary

The following tables present a summary of the investments by type as of June 30, 2006 and 2005.

Pension Funds
Years Ended June 30, 2006 and 2005

Investment Summary

	2006	2005
U.S. Gov't & Agency Fixed Income Securities	\$ 3,251,063,919	\$ 3,313,946,410
U.S. Corporate Fixed Income Securities	1,416,970,614	1,268,342,165
Municipal Debt Securities	12,901,977	14,883,806
Short-term Investments	240,887,409	353,054,725
Equity Securities	7,640,279,994	7,219,482,637
Private Equity Limited Partnerships	269,198,441	110,450,122
Real Estate	9,545,575	9,694,317
	<u>\$ 12,840,847,929</u>	<u>\$ 12,289,854,182</u>

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS--CONTINUED

Insurance Funds Years Ended June 30, 2006 and 2005

Investment Summary

	2006	2005
U.S. Gov't & Agency Fixed Income Securities	\$ 220,781,808	\$ 189,294,988
Short-term Investments	233,849,474	219,965,717
Equity Securities	1,705,352,668	1,485,569,035
Private Equity Limited Partnerships	29,910,939	12,272,237
Alternative Investment	135,000	
	\$2,190,029,889	\$1,907,101,978

Credit Risk of Debt Securities - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The debt security portfolios are managed by the Investment Division staff and by external professional investment management firms. All portfolio managers are required by the Statement of Investment Policy to maintain diversified portfolios. Each portfolio is also required to be in compliance with risk management guidelines that are assigned to them based upon the portfolio's specific mandate. In total, the pension fund debt securities portfolio is managed using the following guidelines adopted by the KRS Board of Trustees:

- Bonds, notes or other obligations issued or guaranteed by the U.S. government, its agencies or instrumentalities are permissible investments and may be held without restrictions.
- The average credit quality of the total portfolio must be A or better.
- Debt obligations must have an investment grade rating at the time of purchase.
- Debt obligations that have been downgraded to below investment grade may be held in the portfolio up to a maximum of 1.5 percent of the total portfolio at market value.
- Debt obligations in the lowest investment grade rating category may not exceed 15 percent of the total portfolio at market value.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS--CONTINUED

The following tables present the KRS pension fund debt ratings at June 30, 2006 and 2005.

Pension Funds		
Debt Securities Investments at Fair Value		
For Years Ended June 30, 2006 and 2005		
<u>Quality Rating</u>	<u>2006</u>	<u>2005</u>
AAA	\$1,677,053,070	\$1,481,814,394
AA+		1,439,266
AA	56,357,290	41,927,341
AA-	106,521,997	84,766,981
A+	117,467,811	196,920,079
A	129,605,231	153,635,654
A-	97,696,399	94,502,023
BBB+	93,215,626	138,345,630
BBB	68,755,102	47,195,847
BBB-	54,767,049	81,970,376
BB+	479,237	20,332,710
NR	104,104,572	26,838,395
Total Credit Risk Debt Securities	<u>2,506,023,384</u>	<u>2,369,688,696</u>
U.S. Government & Agencies	2,174,913,125	2,172,535,022
Pooled Investments		<u>54,948,663</u>
Total Debt Securities	<u>\$4,680,936,509</u>	<u>\$4,597,172,381</u>

At June 30, 2006 and 2005, the weighted average quality rating of the pension fund debt securities portfolio was AA+ and AA+, respectively. KRS had no below investment grade rated debt securities in the pension portfolio at June 30, 2006 and 2005. The fair value of securities in the lowest investment grade rating category was \$-0- at both June 30, 2006 and 2005.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS--CONTINUED

The insurance fund debt securities portfolio, by guidelines, is to be invested in US government securities. As shown below, as of June 30, 2006, the entire insurance fund was invested in Treasury Inflation Protected Securities (TIPS) which carry a US Government treasury rating. As of June 30, 2005, the entire insurance fund consisted of TIPS and US Governmental Short-Term Investment Funds (STIF's).

**Insurance Funds
Credit Risk of Debt Securities
For Years Ended June 30, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
U.S Government & Agencies	\$220,781,808	\$189,294,988
Pooled Investments		9,893,700
Total Credit Risk	<u>\$220,781,808</u>	<u>\$199,188,688</u>

Concentration of Credit Risk Debt Securities - Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's exposure in a single issuer.

The total debt securities portfolio is managed using the following general guidelines adopted by the KRS Board of Trustees:

- Bonds, notes or other obligations issued or guaranteed by the U.S. government, its agencies or instrumentalities are permissible investments and may be held without restrictions.
- Debt obligations of any single U.S. corporation shall be limited to a maximum of 5 percent of the total portfolio at market value.

Except for US government debt securities, there were no individual investments held in either the KRS pension or insurance portfolios at June 30, 2006 or June 30, 2005, that exceeded the maximum issuer 5% limit.

Interest Rate Risk - Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. The effective duration measures the sensitivity of the market price to changes in the yield curve. Effective duration is the most accurate duration measure when a significant portion of the securities are callable (redeemable) prior to maturity. The pension fund portfolio contains a number of securities that are callable and therefore interest rate risk is most appropriately measured by effective duration. The Systems do not have a formal policy that constrains the duration of its fixed income portfolio.

The KRS pension fund debt securities portfolio benchmarks its debt securities portfolio to a blended benchmark consisting of the Lehman Brothers Government Credit Index, the Lehman Brothers Aggregate Index and the Lehman Brothers U.S. TIPS index. At June 30, 2006 and 2005, the effective duration of the blended benchmark was 5.70 and 5.34, respectively. At the same points in time, the effective duration of the KRS pension fund debt securities portfolio was 4.45 and 4.44, respectively.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS--CONTINUED

KRS Pension Funds Interest Rate Risk

	<u>2006</u>	<u>Weighted Average Effective Duration</u>	<u>2005</u>	<u>Weighted Average Effective Duration</u>
Asset Backed Securities	\$ 195,474,695	.80	\$ 252,331,426	1.12
Commercial Mortgage Backed Securities	270,294,818	3.50	109,238,989	3.33
Corporate Bonds	733,297,247	5.67	824,979,866	5.89
Government Agencies	457,938,065	3.58	479,638,805	3.30
Government Bonds	2,167,249,022	4.83	2,189,525,343	5.06
Government Mortgage Backed Securities	625,876,832	4.59	589,833,599	2.91
Municipal Bonds	12,901,977	11.78	14,883,806	12.64
Non-Government Backed Collateralized Mortgage Obligations	217,903,854	2.00	81,791,885	1.19
Pooled Investments			54,948,663	
Total	<u>\$4,680,936,509</u>	<u>4.45</u>	<u>\$ 4,597,172,381</u>	<u>4.44</u>

The KRS insurance fund long-term debt securities portfolio consists entirely of US government issued bonds which are not callable (redeemable) prior to maturity. The modified duration, similar to effective duration, measures the sensitivity of the market prices to changes in the yield curve but does not assume that securities will be called prior to maturity. Since the modified duration measure most accurately reflects the interest rate sensitivity of the insurance fund portfolio, this measure is used for comparative purposes. The KRS insurance fund debt securities portfolio benchmarks its debt securities portfolio to the Lehman Brothers U.S. TIPS Index. At June 30, 2006 and 2005, the modified duration of the benchmark was 7.69 and 8.45, respectively. At the same points in time, the modified duration of the KRS insurance fund debt securities portfolio, excluding the pooled fund, was 8.09 and 8.62, respectively.

**Insurance Funds
Debt Securities Investments at Fair Value
For Years Ended June 30, 2006 and 2005**

<u>Investment</u>	<u>2006</u>		<u>2005</u>	
	<u>Fair Value</u>	<u>Weighted Duration</u>	<u>Fair Value</u>	<u>Weighted Duration</u>
Index Linked Government Bonds	\$220,781,808	8.09	\$189,294,988	8.62
Pooled Debt Securities			9,893,700	NA
	<u>\$220,781,808</u>	<u>8.09</u>	<u>\$199,188,688</u>	<u>8.62</u>

Foreign Currency Risk - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. KRS does not have a formal policy to limit foreign currency risk. The following tables present the KRS' exposure at June 30, 2006 and 2005.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS--CONTINUED

	Pension Funds	
	Investments at Fair Value	
	June 30, 2006 and 2005	
	<u>2006</u>	<u>2005</u>
Foreign Equities		
Australian dollar	\$ 69,810,185	\$ 52,122,988
British pound sterling	326,927,792	300,642,320
Danish krone	5,555,604	6,807,087
Euro	534,096,705	492,597,015
Hong Kong dollar	19,200,448	23,082,401
Japanese yen	420,352,056	346,791,634
New Zealand dollar		3,535,112
Norwegian krone	13,999,004	8,805,025
Singapore dollar	29,048,766	21,641,967
South African rand	2,950,033	
South Korean won		3,366,341
Swedish krona	46,216,722	49,787,195
Swiss franc	121,430,006	109,308,104
International equity mutual fund (various currencies)	508,273,254	484,952,191
Total Securities subject to Foreign Currency Risk	2,097,860,575	1,903,439,380
USD (securities held by International Investment Managers)	<u>45,147,664</u>	<u>78,764,548</u>
Total International Investment Securities	<u>\$ 2,143,008,239</u>	<u>\$ 1,982,203,928</u>

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE D--INVESTMENTS--CONTINUED

Insurance Funds
Investments at Fair Value
June 30, 2006 and 2005

<u>Foreign Equities</u>	<u>2006</u>	<u>2005</u>
Australian dollar	\$ 25,007,521	\$ 21,058,561
British pound sterling	96,076,217	81,925,423
Danish krone	2,834,941	3,540,224
Euro	135,800,378	125,362,499
Hong Kong dollar	6,257,704	6,984,939
Japanese yen	111,488,690	85,596,433
New Zealand dollar		905,291
Norwegian krone	7,061,386	4,558,628
Singapore dollar	5,388,276	3,851,828
Swedish krona	21,656,351	22,215,317
Swiss franc	35,962,006	32,258,586
Total Securities subject to Foreign Currency Risk	447,533,470	388,257,729
USD (securities held by International Investment Managers)	3,676,958	3,610,171
Total International Investment Securities	\$451,210,428	\$391,867,900

NOTE E--SECURITIES LENDING TRANSACTIONS

Kentucky Revised Statutes Sections 61.650 and 386.020(2) permit the Pension and Insurance Funds to lend their securities to broker-dealers and other entities. The borrowers of the securities agree to transfer to the Funds' custodial banks either cash collateral or other securities with a fair value of 102 percent of the value of the borrowed securities. The borrowers of the securities simultaneously agree to return the borrowed securities in exchange for the collateral at a later date. Securities lent for cash collateral are presented as unclassified above in the schedule of custodial credit risk; securities lent for securities collateral are classified according to the category for the securities loaned. At June 30, 2006, the Funds have no credit risk exposure to borrowers because the amounts the Funds owe to borrowers exceed the amounts the borrowers owe the Funds. The contracts with the custodial banks require them to indemnify the Funds if the borrowers fail to return the securities and one or both of the custodial banks have failed to live up to their contractual responsibilities relating to the lending of securities.

Continued

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE E--SECURITIES LENDING TRANSACTIONS--CONTINUED

All securities loans can be terminated on demand by either party to the transaction, although the average term of the loans was 6 days, 10 days, and 24 days for the three investment portfolios subject to security lending agreements. One custodial bank invests cash collateral in securities that are permitted for investment by state statute and board policy, which at year-end has a weighted-average maturity of 3 days for the Funds. The other custodial bank invests cash collateral in the agent's short-term investment pool as permitted by state statute and Board policy, which at year-end has a weighted-average maturity of 24 days for the Pension Fund only. Neither of the Funds can pledge or sell collateral securities received unless the borrower defaults.

NOTE F--RISKS OF LOSS

KRS is exposed to various risks of loss related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Under the provisions of the Kentucky Revised Statutes, the Kentucky Board of Claims is vested with full power and authority to investigate, hear proof, and to compensate persons for damages sustained to either person or property as a result of negligence of the agency or any of its employees. Awards are limited to \$200,000 for a single claim and \$350,000 in aggregate per occurrence. Awards and a pro rata share of the operating cost of the Board of Claims are paid from the fund of the agency having a claim or claims before the Board.

Claims against the Board of Trustees of Kentucky Retirement Systems or any of its staff as a result of an actual or alleged breach of fiduciary duty are insured with a commercial insurance policy. Coverage provided is limited to \$5,000,000 with a deductible amount of \$100,000. Defense costs incurred in defending such claims will be paid by the insurance company. However, the total defense cost and claims paid shall not exceed the total aggregate coverage of the policy.

Claims for job-related illnesses or injuries to employees are insured by the state's self-insured workers' compensation program. Payments approved by the program are not subject to maximum limitations. A claimant may receive reimbursement for all medical expenses related to the illness or injury and up to sixty-six and two-thirds percent (66 2/3%) of wages for temporary disability. Each agency pays premiums based on fund reserves and payroll.

Only claims pertaining to workers' compensation have been filed during the past three fiscal years. Settlements did not exceed insurance coverage in any of the past three fiscal years. There were no claims which were appealed to the Kentucky Workers' Compensation Board.

NOTE G--CONTINGENCIES

In the normal course of business, KRS is involved in various litigation concerning the right of participants or their beneficiaries to receive benefits. KRS does not anticipate any material losses as a result of the contingent liabilities.

NOTE H--INCOME TAX STATUS

The Internal Revenue Service has ruled that KRS qualifies under Section 401(a) of the Internal Revenue Code and is, therefore, not subject to tax under income tax law.

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE I--ANTHEM DEMUTUALIZATION

In 2002, Anthem Insurance Companies, Inc., an Indiana corporation, underwent a demutualization, as authorized by the Indiana statutes. The demutualization provided, among other things, that "eligible statutory members," as defined by Indiana statutory provision, would receive cash or stock in consideration for giving up their membership interest in Anthem. In some instances application of the statute led to the determination by Anthem that individual members of the retirement plans administered by Kentucky Retirement Systems were the "statutory members" and in other instances the Kentucky Retirement Systems was identified by Anthem as the eligible statutory member to receive cash or stock under the Anthem demutualization plan. According to Anthem, this determination was based upon which of Anthem's subsidiaries was the original provider. The determination was confirmed by the Indiana Department of Insurance.

The distribution of approximately \$62 million, which Kentucky Retirement Systems received on January 4, 2002 under the Anthem demutualization, was deposited in the Kentucky Employees Retirement Systems Insurance Fund. The retirement systems included within the Kentucky Retirement Systems for purposes of the Anthem demutualization are the Kentucky Employees Retirement System, (hazardous and non-hazardous), the County Employees Retirement System (hazardous and non-hazardous), the State Police Retirement System, the Legislators' Retirement Plan, and the Judicial Retirement Plan.

Kentucky Retirement Systems was a defendant in a case entitled *Jean C. Love, David E. Wiseman, and Belvia Campbell v. Board of Trustees of the Kentucky Retirement Systems*, which was in Franklin Circuit Court. At issue was how to distribute the proceeds resulting from Anthem's demutualization. The plaintiffs sought to recover the full amount of the proceeds or, alternatively, the pro rata amount of proceeds attributable to insurance premiums that the employees and/or their beneficiaries paid directly.

On June 30, 2006, the parties in the case entered into a Settlement Agreement that was approved on a preliminary basis by the Circuit Court. The Agreement received final approval from the Circuit Court on September 28, 2006. In accordance with the Agreement, \$20 million was transferred to the "Northern Trust Institutional Funds Prime Obligations Portfolio" operated by the Northern Trust Company of Chicago, Illinois (which is the investment custodian for Kentucky Retirement Systems), with such account ("Settlement Fund Savings Account") to be held and controlled exclusively by Kentucky Retirement Systems. This account was created on July 11, 2006.

On, or about, the effective date of the Settlement Agreement of October 29, 2006, Kentucky Retirement Systems will cause all funds contained in the Settlement Fund Savings Account, including any interest earned, to be paid to the Plaintiffs' Counsel in trust for the full, complete and final satisfaction of all claims released pursuant to the Settlement Agreement. The Settlement Fund Savings Account shall be distributed by the Plaintiffs' Counsel as ordered by the Court.

One percent of the remaining balance of approximately \$42 million, plus earnings thereon, will, at a still to be determined date, be distributed to the Legislators' Retirement Plan and the Judicial Retirement Plan. The remainder of the balance will be allocated among the following plans, in the percentages indicated, in the Insurance Fund of Kentucky Retirement Systems': Kentucky Employees Retirement System – Non Hazardous – 51.24%; Kentucky Employees Retirement System – Hazardous – 1.4%; County Employees Retirement System – Non Hazardous – 44.51%; County Employees Retirement Systems – Hazardous – 1.89%; and, State Police Retirement System - .96%. The above percentages were calculated by the Segal Company, the former actuaries of Kentucky Retirement Systems.

KENTUCKY RETIREMENT SYSTEMS

NOTES TO FINANCIAL STATEMENTS--CONTINUED

June 30, 2006

NOTE J--DEFINED BENEFIT PENSION PLAN

All eligible employees of Kentucky Retirement Systems (KRS) participate in the Kentucky Employees Retirement System (non-hazardous), a cost-sharing, multiple-employer defined pension plan that covers substantially all regular full-time employees in non-hazardous positions of any Kentucky State Department, Board or Agency directed by Executive Order to participate in the system. The Plan provides for retirement, disability and death benefits to plan members. Plan benefits are extended to beneficiaries of plan members under certain circumstances. Plan members contributed 5.0% of creditable compensation for the periods ending June 30, 2006, June 30, 2005, and June 30, 2004. KRS contributed 5.89% of covered payroll for the periods ending June 30, 2006, June 30, 2005, and June 30, 2004. The chart below includes the covered payroll and contribution amounts for KRS for the three periods included in this discussion.

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Covered Payroll	\$10,960,000	\$ 9,891,000	\$ 9,035,000
Employer Contributions	\$ 641,200	\$ 572,400	\$ 532,000

NOTE K--EQUIPMENT

Equipment consists of the following:

	June 30	
	<u>2006</u>	<u>2005</u>
Equipment, at cost	\$ 4,039,537	\$ 3,408,106
Less accumulated depreciation	<u>(2,763,017)</u>	<u>(2,576,490)</u>
	<u>\$ 1,276,520</u>	<u>\$ 831,615</u>

Depreciation expense for the years ended June 30, 2006 and 2005 amounted to \$387,292 and \$318,840, respectively.

NOTE L--ALTERNATIVE INVESTMENT

On February 6, 2006, the health insurance fund of Kentucky Retirement Systems loaned to Perimeter Park West, Inc., a related party, \$700,000 for the purchase of real property at 1300 Louisville Road, Frankfort, Kentucky. The loan is not documented by a note, mortgage contract, or security interest in the property. Subsequent to the lending and purchase, the real property was valued by appraisal from \$135,000 to \$290,000. The range of appraisal values is based upon considerations of zoning classifications, site preparations and improvements, and other matters. Kentucky Retirement Systems is reflecting the alternative investment at the lowest appraisal value for the property. Because of the significant difference in the appraised value of the property and the loan amount, and also because the loan is not documented by a note, mortgage contract, or security interest in the property, the Kentucky Retirement Systems is uncertain whether it will be able to collect any principal (or interest) in excess of the minimum appraised property value. Therefore, KRS management has elected to write-down the value of the Alternative Investment to an estimated collectible value of \$135,000. The difference of \$565,000 is included in the Combined Statements of Changes in Plan Net Assets – Insurance Funds as an unrealized loss in “Net Appreciation in Fair Value of Investments.” By a letter dated September 26, 2006, Kentucky Retirement Systems filed a notice of claim with its fiduciary insurance carrier (the Federal Insurance Company) asserting monetary damages in excess of \$600,000 to the health insurance fund as a result of the loan.

REQUIRED SUPPLEMENTARY INFORMATION

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)--PENSION FUNDS

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll [(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 2001	\$ 6,844,742,687	\$ 5,444,035,294	\$ (1,400,707,393)	125.7	\$ 1,505,299,220	(93.1)
June 30, 2002*	6,654,084,196	6,026,094,764	(627,989,432)	110.4	1,595,809,458	(39.3)
June 30, 2003**	6,351,318,832	6,520,463,188	169,144,356	97.4	1,658,604,696	10.2
June 30, 2004**	6,000,513,743	7,049,613,171	1,049,099,428	85.1	1,645,412,496	63.8
June 30, 2005**	5,578,685,746	7,579,074,839	2,000,389,093	73.6	1,655,907,288	120.8
June 30, 2006**	5,394,086,323	8,994,826,247	3,600,739,924	60.0	1,702,230,777	211.5
<u>Hazardous</u>						
June 30, 2001	\$ 361,677,475	\$ 285,193,761	\$ (76,483,714)	126.8	\$ 122,857,992	(62.3)
June 30, 2002*	376,384,302	322,069,164	(54,315,138)	116.9	125,275,925	(43.4)
June 30, 2003**	385,925,722	356,879,133	(29,046,589)	108.1	129,088,956	(22.5)
June 30, 2004**	397,212,763	403,578,036	6,365,273	98.4	126,664,812	5.0
June 30, 2005**	405,288,662	439,013,910	33,725,248	92.3	131,687,088	25.6
June 30, 2006**	427,984,192	508,655,903	80,671,711	84.1	138,747,320	58.1
<u>Total</u>						
June 30, 2001	\$ 7,206,420,162	\$ 5,729,229,055	\$ 1,477,191,107	125.8	\$ 1,628,157,212	(90.7)
June 30, 2002*	7,030,468,498	6,348,163,928	682,304,570	110.7	1,721,085,383	(39.6)
June 30, 2003**	6,737,244,554	6,877,342,321	140,097,767	98.0	1,787,693,652	11.1
June 30, 2004**	6,397,726,506	7,453,191,207	1,055,464,701	85.8	1,772,077,308	59.6
June 30, 2005**	5,983,974,408	8,018,088,749	2,034,114,341	74.6	1,787,594,376	113.8
June 30, 2006**	5,822,070,515	9,503,482,151	3,681,411,635	61.3	1,840,978,097	200.0

*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

**Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)--PENSION FUNDS

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll [(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 2001	\$ 5,423,834,549	\$ 3,706,282,212	\$ (1,717,552,337)	146.3	\$ 1,544,973,296	(111.2)
June 30, 2002*	5,397,787,158	4,165,355,149	(1,232,432,009)	129.6	1,663,183,629	(74.1)
June 30, 2003**	5,286,580,047	4,417,597,802	(868,982,245)	119.7	1,796,451,180	(48.4)
June 30, 2004**	5,187,851,530	4,936,459,488	(251,392,042)	105.1	1,826,870,880	(13.8)
June 30, 2005**	5,059,208,687	5,385,306,505	326,097,818	93.9	1,885,275,000	17.3
June 30, 2006**	5,162,894,136	6,179,569,267	1,016,675,131	83.5	1,982,437,473	51.3
<u>Hazardous</u>						
June 30, 2001	\$ 1,486,666,016	\$ 1,193,860,442	\$ (292,805,574)	124.5	\$ 316,700,304	(92.5)
June 30, 2002*	1,485,511,793	1,327,291,273	(158,220,520)	111.9	345,849,277	(45.7)
June 30, 2003**	1,467,004,856	1,499,628,782	32,623,926	97.8	374,700,732	8.7
June 30, 2004**	1,457,612,042	1,640,830,120	183,218,078	88.8	392,562,624	46.7
June 30, 2005**	1,452,353,023	1,795,617,335	343,264,312	80.9	411,121,728	83.5
June 30, 2006**	1,515,075,017	2,020,142,770	505,067,753	75.0	426,927,550	118.3
<u>Total</u>						
June 30, 2001	\$ 6,910,500,565	\$ 4,900,142,654	\$ (2,010,357,911)	141.0	\$ 1,861,673,600	(108.0)
June 30, 2002*	6,883,298,951	5,492,646,422	(1,390,652,529)	125.3	2,009,032,906	(69.2)
June 30, 2003**	6,753,584,903	5,917,226,584	(836,358,319)	114.1	2,171,151,912	(38.5)
June 30, 2004**	6,645,463,572	6,577,289,608	(68,173,964)	101.0	2,219,433,504	(3.1)
June 30, 2005**	6,511,561,710	7,180,923,840	669,362,130	90.7	2,296,396,728	29.2
June 30, 2006**	6,677,969,153	8,199,712,037	1,521,742,884	81.4	2,409,365,023	63.2

*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

**Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

STATE POLICE RETIREMENT SYSTEM (SPRS)--PENSION FUNDS

<u>Year Ended</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Entry Age Normal (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Percent Funded (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a % of Covered Payroll [(b-a)/c]</u>
June 30, 2001	\$ 456,160,709	\$ 356,211,860	\$ (99,948,849)	128.1	\$ 44,646,678	(223.7)
June 30, 2002*	438,955,465	380,790,346	(58,165,119)	115.3	44,314,696	(131.2)
June 30, 2003**	413,063,576	414,881,459	1,817,883	99.6	43,760,832	4.2
June 30, 2004**	385,077,195	437,482,425	52,405,230	88.0	43,835,208	119.6
June 30, 2005**	353,511,622	458,593,576	105,081,954	77.1	43,720,092	240.4
June 30, 2006**	344,016,197	516,482,298	172,466,101	66.6	47,743,865	361.2

*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

**Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

KENTUCKY EMPLOYEES RETIREMENT SYSTEMS (KERS)—INSURANCE FUNDS

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll [(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 2001	\$ 449,630,605	\$ 1,769,583,098	\$ 1,319,952,493	25.4	\$ 1,505,299,220	87.7
June 30, 2002*	521,250,455	1,907,683,881	1,386,433,426	27.3	1,595,809,458	86.9
June 30, 2003**	553,885,082	2,093,210,321	1,539,325,239	26.5	1,658,604,696	92.8
June 30, 2004**	600,586,961	2,335,905,365	1,735,318,404	25.7	1,645,412,496	105.5
June 30, 2005**	607,068,351	2,680,559,188	2,073,490,837	22.7	1,655,907,288	125.2
June 30, 2006**	611,350,765	7,815,480,774	7,204,130,009	7.8	1,702,230,777	423.2
<u>Hazardous</u>						
June 30, 2001	\$ 119,372,742	\$ 214,450,822	\$ 95,078,080	55.7	\$ 122,857,992	77.4
June 30, 2002*	135,874,582	236,819,050	100,944,468	57.4	125,275,925	80.6
June 30, 2003**	151,459,500	283,178,335	131,718,835	53.5	129,088,956	102.0
June 30, 2004**	169,158,879	323,503,563	154,344,684	52.3	126,664,812	121.9
June 30, 2005**	187,947,644	386,844,695	198,897,051	48.6	131,687,088	151.0
June 30, 2006**	212,833,818	621,237,856	408,404,538	34.3	138,747,320	294.4
<u>Total</u>						
June 30, 2001	\$ 569,003,347	\$ 1,984,033,920	\$ 1,415,030,573	28.7	\$ 1,628,157,212	86.9
June 30, 2002*	657,125,037	2,144,502,931	1,487,377,894	30.6	1,721,085,383	86.4
June 30, 2003**	705,344,582	2,376,388,656	1,671,044,074	29.7	1,787,693,652	93.5
June 30, 2004**	769,745,840	2,659,408,928	1,889,663,088	28.9	1,772,077,308	106.6
June 30, 2005**	795,015,995	3,067,403,883	2,272,387,888	25.9	1,787,594,376	127.1
June 30, 2006**	824,184,083	8,436,718,630	7,612,534,547	9.8	1,840,178,097	413.5

*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

**Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

COUNTY EMPLOYEES RETIREMENT SYSTEMS (CERS)—INSURANCE FUNDS

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Targeted Rate (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll [(b-a)/c]
<u>Non-Hazardous</u>						
June 30, 2001	\$ 371,758,628	\$ 1,793,710,768	\$ 1,421,952,140	20.7	\$ 1,544,973,296	92.0
June 30, 2002*	450,497,307	1,977,577,038	1,527,079,731	22.8	1,663,183,629	91.8
June 30, 2003**	520,060,105	2,176,963,259	1,656,903,154	23.9	1,796,451,180	92.2
June 30, 2004**	585,399,072	2,438,734,696	1,853,335,624	24.0	1,826,870,880	101.5
June 30, 2005**	663,941,949	2,788,754,654	2,124,812,705	23.8	1,885,275,000	112.7
June 30, 2006**	777,726,590	4,607,223,639	3,829,497,049	16.9	1,982,437,473	193.2
<u>Hazardous</u>						
June 30, 2001	\$ 197,875,249	\$ 721,605,292	\$ 523,730,043	27.4	\$ 316,700,304	165.4
June 30, 2002*	234,683,878	781,184,974	546,501,096	30.1	345,849,279	158.0
June 30, 2003**	269,190,080	935,650,662	666,460,582	28.8	374,700,732	177.9
June 30, 2004**	310,578,162	1,025,684,477	715,106,315	30.3	392,562,624	182.2
June 30, 2005**	359,180,461	1,283,299,092	924,118,631	28.0	411,121,728	224.8
June 30, 2006**	422,785,042	1,928,481,371	1,505,696,329	21.9	426,927,550	352.7
<u>Total</u>						
June 30, 2001	\$ 569,633,877	\$ 2,515,316,060	\$ 1,945,682,183	22.6	\$ 1,861,673,600	104.5
June 30, 2002*	685,181,185	2,758,762,012	2,073,580,827	24.8	2,009,032,908	103.2
June 30, 2003**	789,250,185	3,112,613,921	2,323,363,736	25.4	2,171,151,912	107.0
June 30, 2004**	895,977,234	3,464,419,173	2,568,441,939	25.9	2,219,433,504	115.7
June 30, 2005**	1,023,122,410	4,072,053,746	3,048,931,336	25.1	2,296,396,728	132.8
June 30, 2006**	1,200,511,632	6,535,705,010	5,335,193,378	18.4	2,409,365,023	221.4

*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

**Covered payroll was actuarially computed as opposed to estimated in prior years.

Continued

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS--CONTINUED

STATE POLICE RETIREMENT SYSTEMS (SPRS)--INSURANCE FUNDS

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Targeted Rate (b)	Unfunded AAL (UAAL) (b-a)	Percent Funded (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll [(b-a)/c]
June 30, 2001	\$ 79,863,577	\$ 158,261,479	\$ 78,397,902	50.5	\$ 44,646,678	175.6
June 30, 2002*	86,867,391	165,445,412	78,578,021	52.5	44,314,696	177.3
June 30, 2003**	90,747,967	184,501,205	93,753,238	49.2	43,760,832	214.2
June 30, 2004**	96,622,908	197,604,301	100,981,393	48.9	43,835,208	230.4
June 30, 2005**	100,207,082	234,159,510	133,952,428	42.8	43,720,092	306.4
June 30, 2006**	105,580,269	582,580,867	477,000,598	18.1	47,743,865	999.1

*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

**Covered payroll was actuarially computed as opposed to estimated in prior years.

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)

<u>Year Ended</u>	<u>NON-HAZARDOUS</u>								
	<u>Pension</u>			<u>Insurance</u>			<u>Total</u>		
	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 2001	\$ 21,787,253	\$ 23,482,080	107.8	\$ 66,874,871	\$ 66,874,871	100.0	\$ 88,662,124	\$ 90,356,951	101.9
June 30, 2002		1,760,328		93,993,177	93,912,017	99.9	93,993,177	95,672,345	101.8
June 30, 2003	4,905,399	7,597,450	134.9	92,052,561	65,335,219	71.0	96,957,960	72,932,669	75.2
June 30, 2004	47,739,067	21,696,543	45.4	77,951,553	78,016,737	100.1	125,690,620	99,713,280	79.3
June 30, 2005	85,798,943	50,332,750	58.7	86,974,271	49,909,228	57.4	172,773,214	100,241,978	58.0
June 30, 2006	137,330,718	60,680,607	44.2	100,942,451	43,748,669	43.3	238,273,169	104,429,276	43.8

<u>Year Ended</u>	<u>HAZARDOUS</u>								
	<u>Pension</u>			<u>Insurance</u>			<u>Total</u>		
	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 2001	\$ 9,920,148	\$ 10,626,663	107.1	\$ 13,226,298	\$ 13,226,298	100.0	\$ 23,146,446	\$ 23,852,961	103.1
June 30, 2002	7,742,052	17,933,817	102.5	15,859,932	15,887,399	100.2	23,601,984	23,821,216	100.9
June 30, 2003	8,511,402	7,322,607	86.0	15,839,215	15,883,263	100.3	24,350,617	23,205,870	95.3
June 30, 2004	9,600,978	9,769,580	101.8	14,942,092	14,959,617	100.1	24,543,070	24,729,197	100.8
June 30, 2005	9,449,878	9,758,547	103.3	15,892,977	15,395,977	96.9	25,342,855	25,154,524	99.3
June 30, 2006	12,128,538	10,803,206	89.1	18,605,633	16,243,103	87.3	30,734,171	27,046,309	88.0

<u>Year Ended</u>	<u>TOTAL</u>								
	<u>Pension</u>			<u>Insurance</u>			<u>Total</u>		
	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 2001	\$ 31,707,401	\$ 34,108,743	107.6	\$ 80,101,169	\$ 80,101,169	100.0	\$ 111,808,570	\$ 114,209,912	102.1
June 30, 2002	7,742,052	9,694,145	125.2	109,853,109	109,799,416	100.0	117,595,161	119,493,561	101.6
June 30, 2003	13,416,801	14,920,057	111.2	107,891,776	81,218,482	75.3	121,308,577	96,138,539	79.3
June 30, 2004	57,340,045	31,466,123	54.9	92,893,645	92,976,354	100.1	150,233,690	124,442,477	82.8
June 30, 2005	95,248,821	60,091,297	63.1	102,867,248	65,305,205	63.5	198,116,069	125,396,502	63.3
June 30, 2006	149,459,256	71,483,813	47.8	119,548,084	59,991,772	50.2	269,007,340	131,475,585	48.9

Continued

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)

<u>Year Ended</u>	<u>NON-HAZARDOUS</u>								
	<u>Pension</u>			<u>Insurance</u>			<u>Total</u>		
	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 2001	\$ 35,658,922	\$ 48,914,435	137.2	\$ 62,292,385	\$ 62,292,385	100.0	\$ 97,951,307	\$ 111,206,820	113.5
June 30, 2002	3,326,367	5,528,348	166.2	102,119,475	102,150,543	100.0	105,445,842	107,678,891	102.1
June 30, 2003	8,682,257	11,855,694	136.6	102,038,427	99,234,843	97.3	110,720,684	111,090,537	100.3
June 30, 2004	43,111,505	44,028,465	102.1	89,289,520	89,344,241	100.1	132,401,025	133,372,706	100.7
June 30, 2005	53,117,955	54,616,800	102.8	106,612,633	106,638,253	100.0	159,730,588	161,255,053	101.0
June 30, 2006	89,486,365	90,834,052	101.5	126,460,952	126,480,816	100.0	215,947,317	217,314,868	100.6

<u>Year Ended</u>	<u>HAZARDOUS</u>								
	<u>Pension</u>			<u>Insurance</u>			<u>Total</u>		
	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 2001	\$ 19,409,377	\$ 20,983,360	108.1	\$ 32,149,432	\$ 32,149,432	100.0	\$ 51,558,809	\$ 53,132,792	103.1
June 30, 2002	10,582,988	11,054,949	104.5	45,721,274	45,730,333	100.0	56,304,262	56,785,282	100.9
June 30, 2003	19,920,223	16,905,556	84.9	43,502,755	45,243,950	104.0	63,422,978	62,149,506	98.0
June 30, 2004	27,050,382	27,640,775	102.2	47,018,046	47,036,777	100.0	74,068,428	74,677,552	100.8
June 30, 2005	39,437,725	39,947,747	101.3	54,094,495	54,106,577	100.0	93,532,220	94,054,324	100.6
June 30, 2006	49,589,149	49,976,485	100.8	60,947,804	60,933,604	100.0	100,536,953	110,910,089	100.3

<u>Year Ended</u>	<u>TOTAL</u>								
	<u>Pension</u>			<u>Insurance</u>			<u>Total</u>		
	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 2001	\$ 55,068,299	\$ 69,897,795	126.9	\$ 94,441,817	\$ 94,441,817	100.0	\$ 149,510,116	\$ 164,339,612	109.9
June 30, 2002	13,909,355	16,583,297	119.2	147,840,749	147,880,876	100.0	161,750,104	164,464,173	101.7
June 30, 2003	28,602,480	28,761,250	100.6	145,541,182	144,478,793	99.3	174,143,662	173,240,043	99.5
June 30, 2004	70,161,887	71,669,240	102.1	136,307,566	136,381,018	100.1	206,469,453	208,050,258	100.8
June 30, 2005	92,555,680	94,564,547	102.2	160,707,128	160,744,830	100.0	253,262,808	255,309,377	100.8
June 30, 2006	139,075,514	140,810,537	101.2	187,408,756	187,414,420	100.0	326,484,270	328,224,956	100.5

Continued

KENTUCKY RETIREMENT SYSTEMS

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED

STATE POLICE RETIREMENT SYSTEM (SPRS)

<u>Year Ended</u>	<u>Pension</u>			<u>Insurance</u>			<u>Total</u>		
	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 2001	\$ 1,535,846	\$ 1,515,521	98.7	\$ 8,098,907	\$ 8,113,391	100.2	\$ 9,634,753	\$ 9,628,912	99.9
June 30, 2002		(17,643)		9,563,111	9,579,899	100.1	9,563,111	9,562,256	100.0
June 30, 2003		(20,061)		9,443,588	7,654,313	81.1	9,443,588	7,634,252	80.8
June 30, 2004	1,175,711	1,152,752	98.0	8,434,834	8,455,498	100.2	9,610,545	9,608,250	100.0
June 30, 2005	3,730,805	2,851,461	76.4	8,608,536	6,631,031	77.0	12,339,341	9,482,492	76.8
June 30, 2006	6,888,805	4,244,445	61.6	9,669,999	5,990,265	61.9	16,558,804	10,234,710	61.8

KENTUCKY RETIREMENT SYSTEMS

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

PENSION FUNDS

	<u>Non-Hazardous</u>	<u>Hazardous</u>
Valuation Date	June 30, 2006	June 30, 2006
Actuarial Cost Method	Entry Age	Entry Age
Amortization Method	Level Percent Closed	Level Percent Closed
Remaining Amortization Period	14-30 Years	14-30 Years
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market
Actuarial Assumptions:		
Investment Return	7.75%	7.75%
Projected Salary Increases	4.0-13.5%	4.0-14.5%
Cost-of-Living Adjustment	None	None
Includes Inflation Rate at	3.50%	3.50%

INSURANCE FUNDS

	<u>Non-Hazardous</u>	<u>Hazardous</u>
Valuation Date	June 30, 2006	June 30, 2006
Actuarial Cost Method	Entry Age	Entry Age
Asset Valuation Method	Five-year smoothed Market	Five-year smoothed Market
Remaining Amortization Period	30 Years	30 Years
Medical Trend Assumption	12.00-5.50%	12.00-5.50%
Year of Ultimate Trend	2027	2027
Actuarial Assumptions:		
Investment Return*	4.50/7.75%	4.50/7.75%
Includes Inflation Rate at*	3.50%	3.50%

*Note: Relative to the insurance funds, the investment return assumption for the KERS non-hazardous fund and the SPRS fund is 4.50% as required under GASB Statements No. 43 and 45 due to the lack of pre-funding in these respective funds. The remaining funds utilize a 7.75% investment return assumption.

ADDITIONAL SUPPORTING SCHEDULES

KENTUCKY RETIREMENT SYSTEMS

SCHEDULE OF ADMINISTRATIVE EXPENSES

	Years ended June 30	
	<u>2006</u>	<u>2005</u>
	(Dollars in thousands)	
Personal Services		
Salaries and per diem	\$ 13,041	\$ 10,139
Fringe benefits	2,964	2,500
Tuition assistance	<u>91</u>	<u>66</u>
Total personal services	16,096	12,705
Contractual Services		
Actuarial	161	157
Audit	23	41
Legal	522	397
Medical	288	224
Contractual	<u>1,354</u>	<u>735</u>
Total contractual services	2,348	1,554
Communication		
Printing	254	219
Telephone	172	136
Postage	637	549
Travel	<u>218</u>	<u>157</u>
Total communication	1,281	1,061
Rentals		
Office space	980	981
Equipment	<u>57</u>	<u>58</u>
Total rentals	1,037	1,039
Miscellaneous		
Utilities	221	147
Supplies	165	137
Insurance	61	56
Maintenance	300	330
Other	<u>361</u>	<u>84</u>
Total miscellaneous	1,108	754
Depreciation	387	319
Healthcare Administrative Fees	<u>3,562</u>	<u>1,231</u>
Total Administrative Expenses	<u>\$ 25,819</u>	<u>\$ 18,663</u>

KENTUCKY RETIREMENT SYSTEMS

SCHEDULE OF INVESTMENT EXPENSES

	Years ended June 30	
	<u>2006</u>	<u>2005</u>
	(Dollars in thousands)	
PENSION FUNDS		
Security Lending Fees		
Broker rebates	\$ 124,694	\$ 47,836
Lending agent fees	<u>2,463</u>	<u>1,745</u>
Total security lending	127,157	49,581
Common Stock Commissions	8,212	5,818
Contractual Services		
Investment management	10,156	9,026
Security custody	288	749
Investment consultant	111	313
Investment related travel	<u>57</u>	<u>50</u>
Total contractual services	10,611	10,138
INSURANCE FUNDS		
Security Lending Fees		
Broker rebates	20,294	7,668
Lending agent fees	<u>366</u>	<u>263</u>
Total security lending	20,660	7,931
Common Stock Commissions	567	563
Investment Management	<u>1,889</u>	<u>1,428</u>
Total investment expenses	<u>\$ 169,096</u>	<u>\$ 75,459</u>

Information on fees paid to investment professionals can be found in the investment section of the Comprehensive Annual Financial Report.

KENTUCKY RETIREMENT SYSTEMS

SCHEDULE OF PROFESSIONAL CONSULTANT FEES

	Years ended June 30	
	<u>2006</u>	<u>2005</u>
	(Dollars in thousands)	
Actuarial Services	\$ 161	\$ 157
Medical Review Services	288	224
Audit Services	23	41
Legal Counsel	522	397
Compliance	136	79
Workflow	364	236
Healthcare	750	298
Banking	51	60
Miscellaneous	<u>53</u>	<u>62</u>
Total	<u>\$ 2,348</u>	<u>\$ 1,554</u>

KENTUCKY RETIREMENT SYSTEMS

COMBINING SCHEDULES OF PLAN NET ASSETS--PENSION FUNDS

As of June 30, 2006 (with Comparative Totals as of June 30, 2005)

(Dollars in Thousands)

	2006					2005	
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
ASSETS							
Cash and short-term investments							
Cash	\$ 76	\$ 1,890	\$ 231	\$ 723	\$ 90	\$ 3,010	\$ 1,499
Short-term investments	<u>10,775</u>	<u>110,002</u>	<u>29,125</u>	<u>78,875</u>	<u>12,110</u>	<u>240,887</u>	<u>353,055</u>
Total cash and short-term investments	10,851	111,892	29,356	79,598	12,200	243,897	354,554
Receivables							
Contributions	2,093	22,798	10,140	28,575	1,290	64,896	66,599
Investment income	<u>1,857</u>	<u>23,985</u>	<u>6,962</u>	<u>24,108</u>	<u>1,572</u>	<u>58,484</u>	<u>56,760</u>
Total receivables	3,950	46,783	17,102	52,683	2,862	123,380	123,359
Investments, at fair value							
Corporate and government bonds	119,243	1,566,064	458,433	1,586,655	105,004	3,835,399	3,955,223
Corporate stocks	273,168	3,412,964	913,987	3,097,796	211,565	7,909,480	7,329,933
Mortgages	28,399	305,668	109,687	380,849	20,933	845,536	641,949
Real estate	<u>1,943</u>	<u>2,346</u>	<u>2,415</u>	<u>2,360</u>	<u>481</u>	<u>9,545</u>	<u>9,693</u>
Total investments at fair value	422,753	5,287,042	1,484,522	5,067,660	337,983	12,599,960	11,936,798
Securities lending collateral invested	159,497	1,094,684	603,606	1,489,805	108,101	3,455,693	2,635,518
Equipment (net of accumulated depreciation)	<u>36</u>	<u>437</u>	<u>65</u>	<u>731</u>	<u>8</u>	<u>1,277</u>	<u>832</u>
Total Assets	<u>597,087</u>	<u>6,540,838</u>	<u>2,134,651</u>	<u>6,690,477</u>	<u>461,154</u>	<u>16,424,207</u>	<u>15,051,061</u>
LIABILITIES							
Accounts payable	560	6,021	2,200	9,295	212	18,288	10,352
Securities lending collateral	<u>159,497</u>	<u>1,094,684</u>	<u>603,606</u>	<u>1,489,805</u>	<u>108,101</u>	<u>3,455,693</u>	<u>2,635,518</u>
Total Liabilities	<u>160,057</u>	<u>1,100,705</u>	<u>605,806</u>	<u>1,499,100</u>	<u>108,313</u>	<u>3,473,981</u>	<u>2,645,870</u>
Plan Net Assets Held in Trust for Pension Benefits	<u>\$ 437,030</u>	<u>\$ 5,440,133</u>	<u>\$ 1,528,845</u>	<u>\$ 5,191,377</u>	<u>\$ 352,841</u>	<u>\$ 12,950,226</u>	<u>\$ 12,405,191</u>

KENTUCKY RETIREMENT SYSTEMS

COMBINING SCHEDULES OF CHANGES IN PLAN NET ASSETS--PENSION FUNDS

For The Year Ended June 30, 2006 (with Comparative Totals for the Year Ended June 30, 2005)

(Dollars in Thousands)

	2006					2005	
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
ADDITIONS							
Members' contributions	\$ 12,056	\$ 107,607	\$ 39,055	\$ 112,372	\$ 4,814	\$ 275,904	\$ 310,806
Employers' contributions	<u>10,803</u>	<u>60,681</u>	<u>49,976</u>	<u>90,834</u>	<u>4,244</u>	<u>216,538</u>	<u>157,508</u>
Total contributions	22,859	168,288	89,031	203,206	9,058	492,442	468,314
INVESTMENT INCOME							
From investing activities							
Net appreciation in fair value of investments	29,613	356,000	90,189	298,173	29,621	803,596	723,831
Interest/Dividends	<u>12,393</u>	<u>153,648</u>	<u>43,671</u>	<u>150,321</u>	<u>9,976</u>	<u>370,009</u>	<u>344,929</u>
Total investing activities income	42,006	509,648	133,860	448,494	39,597	1,173,605	1,068,760
Investment expense	352	4,466	1,257	4,252	284	10,611	10,138
Commissions	<u>301</u>	<u>3,427</u>	<u>963</u>	<u>3,299</u>	<u>222</u>	<u>8,212</u>	<u>5,818</u>
Total investing activities expense	<u>653</u>	<u>7,893</u>	<u>2,220</u>	<u>7,551</u>	<u>506</u>	<u>18,823</u>	<u>15,956</u>
Net income from investing activities	<u>41,353</u>	<u>501,755</u>	<u>131,640</u>	<u>440,943</u>	<u>39,091</u>	<u>1,154,782</u>	<u>1,052,804</u>
From Securities Lending Activities							
Securities lending income	6,196	42,886	23,485	57,969	4,234	134,770	55,872
Securities lending expense:							
Security borrower rebates	5,755	39,500	21,780	53,758	3,901	124,694	47,836
Security lending agent fees	<u>114</u>	<u>780</u>	<u>430</u>	<u>1,062</u>	<u>77</u>	<u>2,463</u>	<u>1,745</u>
Net income from securities lending activities	<u>327</u>	<u>2,606</u>	<u>1,275</u>	<u>3,149</u>	<u>256</u>	<u>7,613</u>	<u>6,291</u>
Total net investment income	<u>41,680</u>	<u>504,361</u>	<u>132,915</u>	<u>444,092</u>	<u>39,347</u>	<u>1,162,395</u>	<u>1,059,095</u>
Total Additions	64,539	672,649	221,946	647,298	48,405	1,654,837	1,527,409

	2006					2005	
	KERS	KERS	CERS	CERS	SPRS	Total	Total
	<u>Hazardous</u>	<u>Non-Hazardous</u>	<u>Hazardous</u>	<u>Non-Hazardous</u>			
DEDUCTIONS							
Benefit payments	\$ 23,736	\$ 577,947	\$ 101,087	\$ 325,135	\$ 34,703	\$ 1,062,608	\$ 960,521
Refunds	1,436	9,632	2,147	11,589	133	24,937	23,896
Administrative expenses	<u>645</u>	<u>7,568</u>	<u>1,113</u>	<u>12,797</u>	<u>134</u>	<u>22,257</u>	<u>17,432</u>
Total deductions	<u>25,817</u>	<u>595,147</u>	<u>104,347</u>	<u>349,521</u>	<u>34,970</u>	<u>1,109,802</u>	<u>1,001,849</u>
Net increase in plan assets	38,722	77,502	117,599	297,777	13,435	545,035	525,560
Plan net assets held in trust for Pension Benefits							
Beginning of Year	<u>398,308</u>	<u>5,362,631</u>	<u>1,411,246</u>	<u>4,893,600</u>	<u>339,406</u>	<u>12,405,191</u>	<u>11,879,631</u>
End of Year	<u>\$ 437,030</u>	<u>\$ 5,440,133</u>	<u>\$ 1,528,845</u>	<u>\$ 5,191,377</u>	<u>\$ 352,841</u>	<u>\$ 12,950,226</u>	<u>\$ 12,405,191</u>

KENTUCKY RETIREMENT SYSTEMS

COMBINING SCHEDULES OF PLAN NET ASSETS--INSURANCE FUNDS

As of June 30, 2006 (with Comparative Totals as of June 30, 2005)
(Dollars in Thousands)

ASSETS	2006					2005	
	KERS Hazardous	KERS Non-Hazardous	CERS Hazardous	CERS Non-Hazardous	SPRS	Total	Total
Cash and short-term investments							
Cash	\$ 35	\$ 98	\$ 51	\$ 74	\$ 7	\$ 265	\$ 207
Short-term investments	<u>20,824</u>	<u>99,493</u>	<u>36,092</u>	<u>68,375</u>	<u>9,066</u>	<u>233,850</u>	<u>210,072</u>
Total cash and short-term investments	20,859	99,591	36,143	68,449	9,073	234,115	210,279
Receivables							
Contributions	902	3,849	6,855	18,309	378	30,293	18,617
Investment income	<u>529</u>	<u>1,602</u>	<u>1,085</u>	<u>1,957</u>	<u>267</u>	<u>5,440</u>	<u>4,909</u>
Total receivables	1,431	5,451	7,940	20,266	645	35,733	23,526
Investments, at fair value							
Corporate and government bonds	20,994	61,783	46,358	80,958	10,689	220,782	199,189
Corporate stocks	180,360	467,311	351,926	645,459	90,208	1,735,264	1,497,841
Alternative investment	<u>15</u>	<u>15</u>	<u>37</u>	<u>61</u>	<u>7</u>	<u>135</u>	
Total investments	201,369	529,109	398,321	726,478	100,904	1,956,181	1,697,030
Security lending collateral invested	<u>58,213</u>	<u>73,130</u>	<u>128,623</u>	<u>215,816</u>	<u>25,561</u>	<u>501,343</u>	<u>431,552</u>
Total Assets	<u>281,872</u>	<u>707,281</u>	<u>571,027</u>	<u>1,031,009</u>	<u>136,183</u>	<u>2,727,372</u>	<u>2,362,387</u>
LIABILITIES							
Accounts payable	201	1,566	1,283	2,195	162	5,407	2,230
Demutualization proceeds payable		20,000				20,000	
Securities lending collateral obligations	<u>58,213</u>	<u>73,130</u>	<u>128,623</u>	<u>215,816</u>	<u>25,561</u>	<u>501,343</u>	<u>431,552</u>
Total Liabilities	<u>58,414</u>	<u>94,696</u>	<u>129,906</u>	<u>218,011</u>	<u>25,723</u>	<u>526,750</u>	<u>433,782</u>
Plan Net Assets Held in Trust for Insurance Benefits	<u>\$ 223,458</u>	<u>\$ 612,585</u>	<u>\$ 441,121</u>	<u>\$ 812,998</u>	<u>\$ 110,460</u>	<u>\$ 2,200,622</u>	<u>\$ 1,928,605</u>

KENTUCKY RETIREMENT SYSTEMS

COMBINING SCHEDULES OF CHANGES IN PLAN NET ASSETS--INSURANCE FUNDS

For The Year Ended June 30, 2006 (with Comparative Totals for the Year Ended June 30, 2005)

(Dollars in Thousands)

	2006					2005	
	KERS	KERS	CERS	CERS	SPRS	Total	Total
	Hazardous	Non-Hazardous	Hazardous	Non-Hazardous			
ADDITIONS							
Employers' contributions	\$ 16,243	\$ 43,749	\$ 60,934	\$ 126,481	\$ 5,990	\$ 253,397	\$ 232,681
Premiums received from retirees	88	5,770	98	6,365	5	12,326	
Insurance Appropriation	<u>769</u>	<u>3,886</u>	<u>3,920</u>	<u>2,387</u>	<u>890</u>	<u>11,852</u>	<u>4,562</u>
Total contributions	17,100	53,405	64,952	135,233	6,885	277,575	237,243
INVESTMENT INCOME							
From investing activities							
Net appreciation in fair value of investments	19,778	53,531	36,684	68,331	9,907	188,231	122,127
Interest/Dividends	<u>4,393</u>	<u>12,626</u>	<u>8,619</u>	<u>15,741</u>	<u>2,204</u>	<u>43,583</u>	<u>36,400</u>
Total income from investing activities	24,171	66,157	45,303	84,072	12,111	231,814	158,526
Investment expense	212	443	392	741	101	1,889	1,428
Commissions	<u>61</u>	<u>162</u>	<u>112</u>	<u>201</u>	<u>31</u>	<u>567</u>	<u>563</u>
Total investing activities expense	<u>273</u>	<u>605</u>	<u>504</u>	<u>942</u>	<u>132</u>	<u>2,456</u>	<u>1,991</u>
Net income from investing activities	<u>23,898</u>	<u>65,552</u>	<u>44,799</u>	<u>83,130</u>	<u>11,979</u>	<u>229,358</u>	<u>156,535</u>
From Securities Lending Activities							
Securities lending income	2,564	3,242	5,661	9,502	1,125	22,094	9,039
Securities lending expense:							
Security borrower rebates	2,356	2,960	5,207	8,736	1,035	20,294	7,669
Security lending agent fees	<u>43</u>	<u>53</u>	<u>94</u>	<u>158</u>	<u>18</u>	<u>366</u>	<u>262</u>
Net income from securities lending activities	<u>165</u>	<u>229</u>	<u>360</u>	<u>608</u>	<u>72</u>	<u>1,434</u>	<u>1,108</u>
Total net investment income	<u>24,063</u>	<u>65,781</u>	<u>45,159</u>	<u>83,738</u>	<u>12,051</u>	<u>230,792</u>	<u>157,643</u>
Total Additions	41,163	119,186	110,111	218,971	18,936	508,367	394,886

	2006					2005	
	KERS	KERS	CERS	CERS	SPRS	Total	Total
	Hazardous	Non-Hazardous	Hazardous	Non-Hazardous			
DEDUCTIONS							
Healthcare premiums subsidies	\$ 6,370	\$ 78,156	\$ 28,714	\$ 56,985	\$ 7,252	\$ 177,477	\$ 166,892
Administrative fees	63	1,679	213	1,539	68	3,562	1,231
Self-funding insurance	143	17,667	1,003	15,934	564	35,311	
Demutualization proceeds refunded		20,000				20,000	
Total deductions	<u>6,576</u>	<u>117,502</u>	<u>29,930</u>	<u>74,458</u>	<u>7,884</u>	<u>236,350</u>	<u>168,123</u>
Net increase in plan assets	34,587	1,684	80,181	144,513	11,052	272,017	226,763
Plan net assets held in trust for insurance benefits							
Beginning of Year	<u>188,871</u>	<u>610,901</u>	<u>360,940</u>	<u>668,485</u>	<u>99,408</u>	<u>1,928,605</u>	<u>1,701,842</u>
End of Year	<u>\$ 223,458</u>	<u>\$ 612,585</u>	<u>\$ 441,121</u>	<u>\$ 813,998</u>	<u>\$ 110,460</u>	<u>\$ 2,200,622</u>	<u>\$ 1,928,605</u>

**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**

Board of Trustees
Kentucky Retirement Systems
Frankfort, Kentucky

We have audited the financial statements of Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2006, and have issued our report thereon dated August 31, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Kentucky Retirement Systems' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted one matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Kentucky Retirement Systems' ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Finding and Response as item 2006-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weaknesses. However, we do not believe that the reportable condition described above is a material weakness.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether Kentucky Retirement Systems' 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 and other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information of the audit committee, management, and the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



August 31, 2006
Louisville, Kentucky

KENTUCKY RETIREMENT SYSTEMS

SCHEDULE OF FINDING AND RESPONSE

FINDING

ITEM 2006-1, Management Override of Internal Controls

During the fiscal year ended June 30, 2006, two officers of Kentucky Retirement Systems' (KRS) Executive Management, the Chief Investment Officer, and the Chief Operations Officer, circumvented internal control policies and procedures related to an Alternative Investment made by the KRS Insurance Fund.

The Chief Investment Officer and the Chief Operations Officer also failed to perform adequate due diligence in violation of agency practice and industry best practice related to an Alternative Investment by the KRS Insurance Fund. In addition, the Chief Investment Officer and the Chief Operations Officer acted outside the authority granted to them by the Investment Committee when completing the acquisition of the Alternative Investment.

In addition, there was a commingling of funds between the Pension and Insurance Funds to finance the acquisition of the Alternative Investment. This is in violation of the Plan Document and the Internal Revenue Code.

RESPONSE

ITEM 2006-1, Management Override of Internal Controls

The Chief Investment Officer and the Chief Operations Officer have resigned.

KRS has retained fiduciary counsel, Ice Miller, LLP, to review the internal controls in place and will issue an opinion regarding the internal controls at KRS and make recommendations, if necessary.

Also, the Audit Committee of the Board of Trustees of KRS has directed Internal Audit to review internal controls and make recommendations, if necessary. In the interim, it is the opinion of the Executive Management of KRS and Internal Audit that the internal controls are adequate.

Furthermore, Ice Miller, LLP, is in the process of preparing a memorandum with respect to the Alternative Investment and the commingling of funds to detail the self-correcting action taken by KRS.