

# Teachers' Retirement System

*A Component Unit*  
STATE OF  
*of the Commonwealth*  
KENTUCKY  
*of Kentucky*



2006

COMPREHENSIVE  
ANNUAL  
FINANCIAL  
REPORT

for the fiscal year ended June 30, 2006



# **Teachers' Retirement System of the State of Kentucky**

## **The 66th Comprehensive Annual Financial Report**

**A Component Unit of the Commonwealth of Kentucky  
Fiscal Year Ended June 30, 2006**

**Kentucky Teachers' Retirement System  
479 Versailles Road  
Frankfort, Kentucky 40601-3800**

**GARY L. HARBIN  
Executive Secretary**

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This report was prepared by the  
Teachers' Retirement System staff.

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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# INTRODUCTORY SECTION

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for Fiscal Year ending June 30, 2006

## Chairperson's Letter

### Teachers' Retirement System of the State of Kentucky

**GARY L. HARBIN, CPA**  
*Executive Secretary*



December 5, 2006

Dear Members:

On behalf of the Board of Trustees and staff, I am pleased to present this Comprehensive Annual Financial Report of the Teachers' Retirement System of the State of Kentucky for the year ending June 30, 2006, the 66th year of operation of the System. The accompanying reports from the independent auditor and the consulting actuary substantiate the financial integrity and the actuarial soundness of the system.

KTRS closed the 2005-2006 fiscal year with \$13.9 billion net assets. The active membership totaled 73,740 and the retired membership was 38,497 with an annual payroll of \$1.035 billion.

The Board of Trustees is totally committed to managing the retirement system funds in a prudent, professional manner. The retirement system is justly proud of the funding level that the system has achieved. Every effort will be made to insure that the system continues to operate in a fiscally sound manner. Present and future members of the system deserve to be able to avail themselves of the best possible retirement as authorized by statute.

We appreciate the support and cooperation extended by the Governor and the Legislature. This cooperation allows the system to not only meet current challenges but to also make timely provisions for the future.

The Board of Trustees pledges to continue to administer the affairs of the Kentucky Teachers' Retirement System in the most competent and efficient manner possible.

Sincerely,

Zella F. Wells  
Chairperson  
Board of Trustees

#### BOARD OF TRUSTEES

**ZELLA F. WELLS**  
CHAIRPERSON  
PAINTSVILLE

**BARBARA G. STERRETT**  
VICE CHAIRPERSON  
LEXINGTON

**ROBERT M. CONLEY**  
PAINTSVILLE

**JAY MORGAN**  
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**RUTH ANN SWEAZY**  
TAYLORSVILLE

**LAURA ZIMMERMAN**  
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*EX OFFICIO*  
**GENE WILHOIT**  
COMMISSIONER  
DEPARTMENT  
OF EDUCATION

*EX OFFICIO*  
**JONATHAN MILLER**  
STATETREASURER

## Letter of Transmittal



### Teachers' Retirement System of the State of Kentucky

December 5, 2006

Honorable Ernie Fletcher, Governor  
Commonwealth of Kentucky  
Capitol Building  
Frankfort, Kentucky 40601-3800

Dear Governor Fletcher:

It is my pleasure to submit the 66th Comprehensive Annual Financial Report of the Teachers' Retirement System of the State of Kentucky, a Component Unit of the Commonwealth of Kentucky, for the fiscal year ended June 30, 2006.

State law provides the legal requirement for the publication of this report; in addition, an annual audit and an annual actuarial valuation of the retirement system are also required.

Kentucky Teachers' Retirement System (KTRS) has produced an annual report that will provide you, the General Assembly, and the general public, with information necessary to gain a better understanding of the Teachers' Retirement System.

#### **This Report Consists of Five Sections:**

- ❖ The Introductory Section contains the Board Chairperson's letter, this letter of transmittal, Board of Trustees information, a list of consultants used by the System, and the organizational chart.
- ❖ The Financial Section contains the report of the independent auditors, management's discussion and analysis (MD&A), financial statements and required supplementary schedules. Charles T. Mitchell, LLP conducted the 2006 independent audit.

- ❖ The Investment Section presents investment and portfolio performance. This includes the policies, summary, and profile of the System's holdings.
- ❖ The Actuarial Section contains the certification from Cavanaugh MacDonald Consulting, LLC (the consulting actuary service) as well as the results of the System's actuarial valuation.
- ❖ The Statistical Section contains various information on the System's membership, both active and retired. A listing of all participating KTRS employers is also presented in this section.

This report has been prepared in conformity with the principles of governmental accounting and generally accepted accounting principles. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with KTRS management. To the best of our knowledge and belief, the enclosed data is accurate in all material aspects and reported in a manner designed to present fairly the financial position and results of operations of the System for the year ended June 30, 2006. Discussion and analysis of net assets and related additions and deductions is presented in the MD&A beginning on page 15.

Management is responsible for maintaining a system of internal controls to establish reasonable assurance that assets are safeguarded, transactions are accurately executed and financial statements are fairly presented. The system of internal controls includes policies and procedures and an internal audit department that reports to the Executive Secretary.

#### **Profile of KTRS**

Kentucky Teachers' Retirement System was established on July 1, 1940 as a cost-sharing multiple-employer defined benefit plan. The primary purpose of the plan is to provide retirement benefits to the educators and some public employees of the state. KTRS is a blended component unit of the Commonwealth of Kentucky. The plan is described in the notes to the basic financial statements on page 21. Also, the summary of the plan provisions starting on page 76 is useful in understanding benefit and



contribution provisions. The population of our membership is stated in the preceding chairperson's letter.

Each year an operating budget is prepared for the administration of the pension fund. The budget is approved by the Board of Trustees and then submitted to the Kentucky General Assembly for legal adoption. The KTRS investment earnings fund the budget appropriations.

### **Economic Condition**

The economic condition of the System is based primarily on investment earnings. The Investment Section of this report starting on page 46 contains detailed analysis of investments. This section includes asset allocations, rates of return, discussion of the current year market environment and 10 year historical trend schedules.

The investment portfolio experienced significant growth during the 2005-2006 fiscal year. The portfolio's par value increased from \$12,899,431,557 to \$13,161,470,370. The growth of the portfolio was due to investment income that included realized capital gains. Employer and employee contributions also provided significant income to the portfolio.

Investment earnings, including appreciation of asset values, net of investment expenses for the 2005-2006 fiscal year were \$724,133,742. The majority of earnings from the System's investment portfolio were the result of net appreciation in fair value of investments in the amount of \$282,572,648. The second largest earnings component, \$262,392,472 was the result of interest income. Other income of \$179,168,622 was generated from dividends, rent and securities lending.

According to KRS 161.430 the KTRS Board of Trustees has the authority to invest the assets of the System. The Board of Trustees, generally, delegates investment authority to an Investment Committee that is comprised of two Trustees and the System's Executive Secretary. The Investment Committee works closely with experienced investment counselors, who are contracted by the Board of Trustees, and the System's professional staff in evaluating and selecting investments.

The investment objectives of the Board of Trustees are to ensure that funds shall be invested solely in the interest of its members and their beneficiaries and that investment income shall be used for the exclusive purpose of providing benefits to the members and their beneficiaries while making payment of reasonable expenses in administering the Plan and its Trust Funds. Also, the investment program shall provide a reasonable rate of total return with major emphasis being placed upon the protection of the invested assets. The entire portfolio earned a total return of 5.4% in 2005-06 and the portfolio's ten year annualized rate of return was 7.5%. During 2005-06, more than 72% of the fixed income investments were rated at least "AAA" in terms of credit quality.

On the state level, KTRS annuities have a bolstering impact on the state's economy, since around 93% of retired teachers reside in Kentucky. Total benefits (retirement, medical...etc.) paid last year were over \$1.195 billion.

### **Funding**

Based on recommendations of the Board of Trustees, the General Assembly establishes the levels of contribution by statute that are to be made by members and employers to fund the liabilities of the system. Each year, an independent actuary performs a valuation to determine whether the current levels of contribution will be sufficient to cover the cost of benefits earned by members.

The latest actuarial valuation was for the period ending June 30, 2006. This report reflects the System's assets, based on modified market value; totaled \$14.5 billion and the liabilities totaled \$19.1 billion. The actuary determined that the existing levels of contribution by members and employers would be sufficient to fund all of the System's liabilities within a reasonable period of time. The report concludes that the System is operating on an actuarially sound basis. Assuming that employer contributions continue in the future at rates recommended on the basis of the successive actuarial valuations, the actuary states that the continued sufficiency of the retirement fund to provide the benefits called for under the System may be safely anticipated.

### **KTRS Medical Insurance Plan**

KTRS health care costs keep escalating at a much faster clip than revenue growth in the Medical Insurance Plan. Last year, basic doctor/hospital costs and the cost of medications (prescription drugs) rose about 6.4%. An actuarial valuation of the Medical Insurance Plan for the fiscal year ended June 30, 2006 indicated that the fund has an unfunded liability of \$4.2 billion for 2006. The KTRS 2004-2006 biennial budget requested additional funding from the Commonwealth, but due to difficult economic times, these funds were not available.

Effective January 1, 1999 KTRS retirees and dependents under the age of 65 have their health insurance provided by plans managed by the Kentucky Department for Employee Insurance. Under this arrangement, KTRS provides a monthly supplement to assist the retiree and their dependents in purchasing their health insurance. Retirees 65 and over remain in the plan administered by KTRS. These retirees also receive a supplement for the cost of their coverage.

The System realizes that these means alone will not solve the medical insurance funding crisis. Additional steps must be taken through legislation on both the state and national levels in order for true cost control to result. Meanwhile, KTRS will address the problem by taking measures to contain costs and by increasing revenues to the insurance fund, adjusting coverage to meet existing revenues, or a combination of the two.

### **Professional Services**

Professional consultants are appointed by the Board of Trustees to perform professional services that are essential to the effective and efficient operation of the KTRS. A certification from the certified public accountant and actuary are enclosed in this report. The system's consultants who are appointed by the Board are listed on pages 8 and 47 of this report.

### **Our Gratitude**

Arthur W. Green, of Elkton, resigned from the Board of Trustees effective June 30, 2006. Mr. Green was elected to the Board in October 1997. Along with his service on various Board

committees, he also served as Chairman of the Investment Committee, Board Vice-Chairman and finally, Board Chairman from July 1, 2005 until June 30, 2006.

During Mr. Green's tenure on the Board, policies were adopted that have greatly improved benefits for Kentucky's retired educators, including the calculation of the retirement benefit on the three highest salary years of employment upon reaching age 55, the addition of the 3.0 percent multiplier for educators retiring with more than 30 years of service, and the addition of part-time teachers and substitute teachers to the field of membership.

On behalf of Kentucky's educators, KTRS staff extends thanks to Mr. Green for his dedicated service to the Kentucky Teachers' Retirement System and wishes him many happy and productive years.

### **National Recognition**

The System was honored by two National professional organizations in regard to the administration of the retirement program.

#### GFOA Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Teachers' Retirement System of the State of Kentucky for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2005. The Certificate of Achievement is a prestigious national award-recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The KTRS has received the Certificate of Achievement for the last

eighteen consecutive years (fiscal years ended 1988-2005). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

PPCC Achievement Award

The Public Pension Coordinating Council awarded a Certificate of Achievement to the Teachers' Retirement System of the State of Kentucky for 2006 for implementing and maintaining high professional standards in administering the affairs of the System. The award is based on compliance with principles judged to underlie exemplary retirement system achievements in the areas of benefits, actuarial valuation, financial reporting, investments and disclosure and are widely acknowledged to be marks of excellence for retirement systems. It represents the highest standards of excellence in the public pension industry.

The PPCC is a coalition of the four major public pension organizations in the nation. These include the National Association of State Retirement Administrators, The National Council on Teacher Retirement, the National Conference on Public Employees Retirement Systems, and the Government Finance Officers Association.

**NCTR Executive Committee**

Gary L. Harbin continues to serve on the Executive Committee of the National Council on Teacher Retirement (NCTR). NCTR is a national, nonprofit organization whose mission is to promote effective governance and benefits administration in state and local public pension systems in order that adequate and secure retirement benefits are provided to educators and other plan participants. NCTR membership includes 77 state, territorial, local and university pension systems with combined assets in excess of 1.4 trillion, serving more than 16 million active and retired teachers, non-teaching personnel and other public employees.

**Public Sector HealthCare Roundtable**

Mr. Harbin also serves on the Board of Directors and as Vice President of the Public Sector HealthCare Roundtable. The Roundtable is a national coalition of public sector health care purchasers that was formed to ensure that the

interests of the public sector are properly represented during the formulation and debate of federal health care reform initiatives. Membership in the Roundtable is open to any statewide, regional or local governmental unit that provides health care coverage for public employees and retirees.

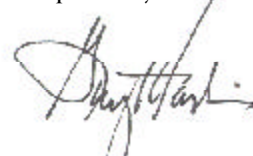
**Acknowledgments**

The preparation of this report reflects the combined efforts of the KTRS staff, under the leadership of the Board of Trustees. The report is intended to provide complete and reliable information that serves as a basis for making management decisions and for determining compliance with legal provisions. It is also used to determine responsible stewardship of the assets contributed by KTRS members and their employers.

This report is located at the KTRS web address [www.ktrs.ky.gov](http://www.ktrs.ky.gov), and is being mailed to all employer members of the System whose cooperation continues to contribute significantly to our success, and who form the vital link between KTRS and its active members.

KTRS management and staff are committed to the continued operation of an actuarially sound retirement system. The support that you have demonstrated in the past is an essential part of this commitment, and we look forward to continuing this positive relationship.

Respectfully submitted,



Gary L. Harbin, CPA  
Executive Secretary

## BOARD OF TRUSTEES



**Dr. Zella F. Wells**  
Chairperson  
Teacher Trustee  
Paintsville



**Barbara G. Sterrett**  
Vice Chairperson  
Retired Teacher Trustee  
Lexington



**Robert M. Conley**  
Lay Trustee  
Paintsville



**Dr. Jay Morgan**  
Teacher Trustee  
Murray



**Ronald L. Sanders**  
Lay Trustee  
Hodgenville



**Ruth Ann Sweazy**  
Teacher Trustee  
Taylorsville



**Laura Zimmerman**  
Teacher Trustee  
Lexington



**Gene Wilhoit**  
Ex Officio Trustee  
Commissioner,  
Dept. of Education



**Jonathan Miller**  
Ex Officio Trustee  
State Treasurer

**Kentucky Teachers' Retirement System**

479 Versailles Road  
Frankfort, Kentucky 40601-3800

**ADMINISTRATIVE STAFF**

**GARY L. HARBIN, CPA**  
*Executive Secretary*

**C. JOE HUTCHISON, MBA, CPA**  
*Deputy Executive Secretary*

**PAUL L. YANCEY, CFA**  
*Chief Investment Officer*

**PROFESSIONAL CONSULTANTS**

**ACTUARY**

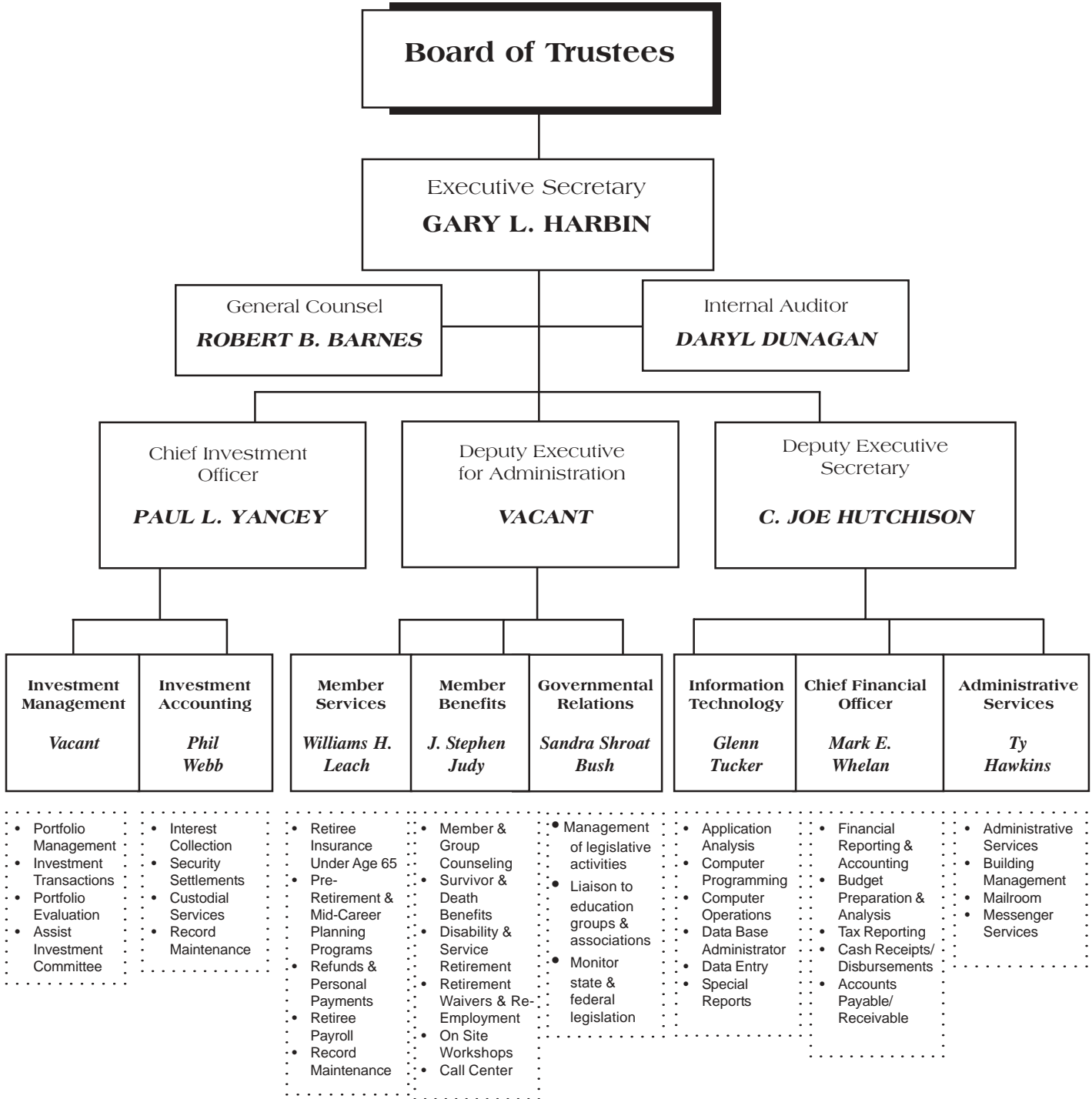
Cavanaugh Macdonald Consulting, LLC  
665 Molly Lane, Suite 150  
Woodstock, Georgia 30189

**AUDITOR**

Charles T. Mitchell, LLP  
201 West Main Street  
P.O. Box 698  
Frankfort, Kentucky 40601

*\* See page 47 of the Investment Section  
for investment consultants.*

## Kentucky Teachers' Retirement System Organizational Chart



Certificate of  
Achievement  
for Excellence  
in Financial  
Reporting

Presented to

Teachers' Retirement System  
of the State of Kentucky

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



*Carla E. Perry*  
President

*Jeffrey R. Egan*  
Executive Director

GOVERNMENT FINANCIAL  
OFFICERS ASSOCIATION (GFOA)

*The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Teachers' Retirement System of the State of Kentucky. The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Teachers' Retirement System of the State of Kentucky. The KTRS has received the Certificate of Achievement for the last seventeen consecutive years (fiscal years ended 1988-2005).*



**Public Pension Coordinating Council  
Public Pension Standards  
2006 Award**

Presented to

**Kentucky Teachers' Retirement System**

In recognition of meeting professional standards for  
plan design and administration as  
set forth in the Public Pension Standards.

*Presented by the Public Pension Coordinating Council, a confederation of*

National Association of state Retirement Administrators (NASRA)  
National Conference on Public Employee Retirement Systems (NCPERS)  
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script, reading 'Alan H. Winkle'.

Alan H. Winkle  
Program Administrator

**PUBLIC PENSION COORDINATING COUNCIL  
PUBLIC PENSION STANDARDS**

*The Public Pension Coordinating Council awarded a Certificate of Achievement to the Teachers' Retirement System of the State of Kentucky for 2006 for implementing and maintaining high professional standards in administering the affairs of the System. The award is based on compliance with principles judged to underlie exemplary retirement system achievements in the areas of benefits, actuarial valuation, financial reporting, investments and disclosure and are widely acknowledged to be marks of excellence for retirement systems. It represents the highest standards of excellence in the public pension industry.*



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# FINANCIAL SECTION

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for Fiscal Year ending June 30, 2006

**Charles T. Mitchell Company, LLP**

**Certified Public Accountants**

**WILLIAM G. JOHNSON, JR., C.P.A.**

**JAMES CLOUSE, C.P.A.**

**BERNADETTE SMITH, C.P.A.**

**KIM FIELD, C.P.A.**

**GREG MIKLAVCIC, C.P.A.**

**Consultants**

**CHARLES T. MITCHELL, C.P.A.**

**DON C. GILES, CPA**



**201 WEST MAIN, P.O. BOX 698  
FRANKFORT, KENTUCKY 40602-0698**

**TELEPHONE (502) 227-7395**

**TELECOPIER (502) 227-8005**

**HTTP://WWW.CTMCPA.COM**

**INDEPENDENT AUDITOR'S REPORT**

Board of Trustees  
Teachers' Retirement System of the State of Kentucky  
Frankfort, Kentucky

We have audited the accompanying statements of plan net assets of the Teachers' Retirement System of the State of Kentucky as of June 30, 2006 and 2005 and the related statements of changes in plan net assets for the years then ended. These component unit financial statements are the responsibility of the Teachers' Retirement System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the plan net assets of the Teachers' Retirement System of the State of Kentucky, a component unit of the Commonwealth of Kentucky, at June 30, 2006 and 2005 and the changes in its plan net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated December 5, 2006 on our consideration of the Teachers' Retirement System of the State of Kentucky's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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.

The Management's Discussion and Analysis on pages 15-18 are not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

The financial section supporting schedules listed in the table-of-contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements. These schedules are the responsibility of the System's management. Such schedules as of and for the year ended June 30, 2006 have been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

We did not audit the data included in the Introductory and Statistical sections of the report and therefore express no opinion on them.

*Charles T. Mitchell Co.*

December 5, 2006

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

This discussion and analysis of Kentucky Teachers' Retirement System's financial performance provides an overview of the defined benefit and medical insurance plans' financial year ended June 30, 2006. Please read it in conjunction with the respective financial statements, which begin on page 19.

### **USING THIS FINANCIAL REPORT**

Because of the long-term nature of a defined benefit pension plan and medical insurance plan, financial statements alone cannot provide sufficient information to properly reflect the plan's ongoing plan perspective. The Statement of Plan Net Assets and Statement of Changes in Plan Net Assets (on pages 19-20) provide information about the activities of the defined benefit plan, medical insurance plan, and the tax-sheltered annuity plan as a whole. The Kentucky Teachers' Retirement System is the fiduciary of funds held in trust for its members.

The Schedule of Funding Progress (on pages 37-38) 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 38-39) 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 TEACHERS' RETIREMENT SYSTEM AS A WHOLE**

In the fiscal year ended June 30, 2006, Kentucky Teachers' Retirement System's combined plan net assets increased by \$315.7 million - from \$13,667.8 million to \$13,983.5 million. The following summaries focus on plan net assets and changes in plan net assets of Kentucky Teachers' Retirement System's defined benefit plan, medical insurance plan, and the tax-sheltered annuity plan.

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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Summary of  
Plan Net Assets  
(In Millions)

Categories	Defined Benefit Plan			Medical Insurance Plan			TOTAL *		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
Cash & Investments	\$14,632.5	\$14,144.4	\$13,486.8	\$132.1	\$153.3	\$159.7	\$14,764.6	\$14,297.7	\$13,646.5
Receivables	94.7	110.0	162.9	7.1	2.3	2.7	101.8	112.3	165.6
Capital Assets	3.2	3.3	3.4				3.2	3.3	3.4
Total Assets	\$14,730.4	\$14,257.7	\$13,653.1	\$139.2	\$155.6	\$162.4	\$14,869.6	\$14,413.3	\$13,815.5
Total Liabilities	(879.0)	(737.7)	(733.5)	(7.6)	(8.3)	(5.8)	(886.6)	(746.0)	(739.3)
Plan Net Assets	\$13,851.4	\$13,520.0	\$12,919.6	\$131.6	\$147.3	\$156.6	\$13,983.0	\$13,667.3	\$13,076.2

\*For the 403(b) Tax Shelter Plan cash and investments were approximately \$.5 million for the years ended 2006 and 2005; and \$.6 million for year 2004.

Summary of  
Changes In Plan Net Assets  
(In Millions)

Categories	Defined Benefit Plan			Medical Insurance Plan			TOTAL		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
<b>ADDITIONS</b>									
Member Contributions	\$258.5	\$247.0	\$238.9	\$51.7	\$51.6	\$52.1	\$310.2	\$298.6	\$291.0
Employer Contributions	410.9	388.3	382.3	89.3	79.0	53.3	500.2	467.3	435.6
Investment Income (net)	717.3	946.1	1,158.2	6.8	6.5	7.1	724.1	952.6	1,165.3
Other Income				6.1			6.1		
TOTAL ADDITIONS	\$1,386.7	\$1,581.4	\$1,779.4	\$153.9	\$137.1	\$112.5	\$1,540.6	\$1,718.5	\$1,891.9
<b>DEDUCTIONS</b>									
Benefit Payments	\$1,035.6	\$963.4	\$885.3				\$1,035.6	\$963.4	\$885.3
Refunds	12.9	11.0	10.5				12.9	11.0	10.5
Administrative Expense	6.8	6.6	6.6	4.6	4.1	3.9	11.4	10.7	10.5
Insurance Expenses				165.0	142.3	117.5	165.0	142.3	117.5
TOTAL DEDUCTIONS	\$1,055.3	\$981.0	\$902.4	\$169.6	\$146.4	\$121.4	\$1,224.9	\$1,127.4	\$1,023.8
Increase (Decrease) in Plan Net Assets	\$331.4	\$600.4	\$877.0	(\$15.7)	(\$9.3)	(\$8.9)	\$315.7	\$591.1	\$868.1

Plan net assets of the defined benefit plan increased by 2.45% (\$13,851.4 million compared to \$13,520 million). The increase is primarily due to continued favorable market conditions which resulted in a net investment gain of \$717.3 million. These assets are restricted to providing monthly retirement allowances to members and their beneficiaries.

Plan net assets of the medical insurance plan decreased by 10.7% (\$131.6 million compared to \$147.3 million) primarily due to insurance expense increases. Plan assets are restricted to providing hospital and medical insurance benefits to members and their spouses.

**DEFINED BENEFIT PLAN ACTIVITIES**

Member contributions increased \$11.5 million. Retirement contributions are calculated by applying a percentage factor to salary and are paid monthly by each member. Members may also pay contributions to repurchase previously refunded service credit or to purchase various types of elective service credit.

Employer contributions totaled \$410.9 million, a net increase of \$22.6 million over the 2005 fiscal year.

The System experienced another gain in net investment, although the gain was less than the previous year (\$717.3 million gain at June 30, 2006 as compared to a \$946.1 million gain at June 30, 2005). The increase in the fair value of investments is mainly due to continued favorable market conditions for the year ended June 30, 2006, yet in comparison the market was not as strong as the year ended June 30, 2005. This can be illustrated as follows:

(In Millions)	<u>2006</u>	<u>2005</u>	<u>2004</u>
Appreciation (depreciation) in fair value of investments – June 30, prior year	\$ 610.4	\$ 171.4	\$ (361.6)
Appreciation (depreciation) in fair value of investments – June 30, end of year	<u>690.4</u>	<u>610.4</u>	<u>171.4</u>
Change in net appreciation (depreciation) in fair value of investments	80.0	439.0	533.0
Net income (net of investment expense)	434.8	433.8	395.0
Net gain on sale of investments	<u>202.5</u>	<u>73.3</u>	<u>230.2</u>
Investment Income (net) – June 30, end of year	\$ 717.3	\$ 946.1	\$1,158.2

Program deductions in 2006 increased \$74.3 million. The increase was caused principally by an increase of \$72.2 million in benefit payments. Members who were drawing benefits as of June 2005 received an increase of 2.2% to their retirement allowances in July 2005. Also, there was an increase of 1,095 members and beneficiaries on the retired payroll as of June 30, 2006.

**MEDICAL INSURANCE PLAN ACTIVITIES**

During the 2006 fiscal year, member contributions increased \$.1 million and employer contributions increased by \$10.3 million over fiscal year 2005. The employer contributions increased primarily because \$62.3 million in stabilization funding was placed in the medical insurance fund from the pension fund at the recommendation of the system's actuary. The amount will be repaid over a ten-year period per KRS 161.553. The employer contribution was based on a .75% allocation of employer contributions as compared to 1.77% for fiscal year 2005.

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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Program deductions increased \$23.2 million due to an increase of insurance expenses of \$22.7 million. The monthly premium subsidy for retirees under age 65 increased 19.3% effective January 1, 2006 with a decrease of 11.6% mandated by the legislature to become effective July 1, 2006. The monthly premium subsidy for retirees age 65 and over increased 9.4%. The increases in monthly insurance premiums for retirees under age 65 were \$20.7 million. The increases in medical claims for retirees age 65 and older were \$1.9 million.

Net investment income increased \$.3 million from \$6.5 million in 2005 to \$6.8 million in 2006. This is due to the recognition of interest income since all investments for the Medical Insurance Plan are short term in nature and the recognition of appreciation in fair value is not feasible. This can be illustrated as follows:

(In Millions)	<u>2006</u>	<u>2005</u>	<u>2004</u>
Appreciation in fair value of investments – June 30, prior year			
Appreciation in fair value of investments – June 30 end of year	\$ 0	\$ 0	\$ 0
Net appreciation in fair value of investments	<u>0</u>	<u>0</u>	<u>0</u>
Net income (net of investment expense)	0	0	0
Net gain on sale of investments	6.8	6.5	7.1
Investment Income (net) – June 30	<u>0</u>	<u>0</u>	<u>0</u>
	\$ 6.8	\$ 6.5	\$ 7.1

### 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 expenses as of the reporting date. Information regarding the actuarial funding status of the defined benefit plan and the medical insurance plan is provided in the Schedule of Funding Progress (beginning on page 37). The asset value, stated in the Schedule of Funding Progress, is determined by the System's independent actuary. The actuarial accrued liability is calculated using the projected unit credit cost method.

The 2006 fiscal year reveals a decline in funding position due to declining financial markets and an increase in actuarial liability. Even under these adverse conditions, the defined benefit plan continues to be well funded.

The medical insurance plan is not as vulnerable to adverse market conditions since its assets are all short term in nature and less likely to experience huge fluctuations. Although, the plan continues to have a large unfunded actuarial liability, the current obligations are being met by current funding.

Annual required contributions of the employers in relation to the required contributions are provided in the Schedule of Employer Contributions (on page 38). This schedule indicates that employers are generally meeting their responsibilities to provide resources to the plans.

FINANCIAL SECTION

**Statement of Plan Net Assets  
As of June 30, 2006 and 2005**

	Defined Benefit Plan		Medical Insurance Plan		403(b) Tax Shelter		TOTAL	
	2006	2005	2006	2005	2006	2005	2006	2005
<b>ASSETS</b>								
Cash	\$9,629,298	\$10,007,055					\$9,629,298	\$10,007,055
Prepaid expenses	96,544	111,389					96,544	111,389
Receivables								
Contributions	29,953,514	25,496,774	\$1,118,926	\$2,267,944			31,072,440	27,764,718
State of Kentucky	5,673,887	19,217,940					5,673,887	19,217,940
Investment income	58,321,829	59,206,811			\$ 71	\$ 46	58,321,900	59,206,857
Investment sales receivable	0	5,150,651					0	5,150,651
Installment account receivable	734,673	946,715					734,673	946,715
Medicare D receivables			5,999,560				5,999,560	
Other receivables	59,932	23,165					59,932	23,165
<b>Total receivables</b>	<b>94,743,835</b>	<b>110,042,056</b>	<b>7,118,486</b>	<b>2,267,944</b>	<b>71</b>	<b>46</b>	<b>101,862,392</b>	<b>112,310,046</b>
Investments, at fair value (See Note 4)								
Short term investments	661,700,340	1,133,906,547	132,083,928	153,361,225	515,732	532,228	794,300,000	1,287,800,000
Bonds and mortgages	4,185,201,899	4,269,791,312					4,185,201,899	4,269,791,312
Common stock	8,531,993,656	7,612,197,454					8,531,993,656	7,612,197,454
Real estate	387,193,796	386,004,453					387,193,796	386,004,453
<b>Total investments</b>	<b>13,766,089,691</b>	<b>13,401,899,766</b>	<b>132,083,928</b>	<b>153,361,225</b>	<b>515,732</b>	<b>532,228</b>	<b>13,898,689,351</b>	<b>13,555,793,219</b>
Invested security lending collateral	856,631,934	732,378,811					856,631,934	732,378,811
Capital assets, at cost net of accumulated depreciation of \$1,764,597 (See Note 2)	3,180,032	3,283,385					3,180,032	3,283,385
<b>Total assets</b>	<b>14,730,371,334</b>	<b>14,257,722,462</b>	<b>139,202,414</b>	<b>155,629,169</b>	<b>515,803</b>	<b>532,274</b>	<b>14,870,089,551</b>	<b>14,413,883,905</b>
<b>LIABILITIES</b>								
Liabilities								
Accounts payable	1,713,031	1,229,294					1,713,031	1,229,294
Treasurer's unredeemed checks	13,823	11,809					13,823	11,809
Insurance claims payable			7,580,738	8,312,899			7,580,738	8,312,899
Compensated absences payable	601,135	604,988					601,135	604,988
Revenues collected in advance			7,391	5,376			7,391	5,376
Investment purchases payable	20,000,000	3,499,614					20,000,000	3,499,614
Obligations under securities lending	856,631,934	732,378,811					856,631,934	732,378,811
<b>Total liabilities</b>	<b>878,959,923</b>	<b>737,724,516</b>	<b>7,588,129</b>	<b>8,318,275</b>	<b>0</b>	<b>0</b>	<b>886,548,052</b>	<b>746,042,791</b>
Net assets held in trust for pension & post-employment healthcare benefits: (See Required Supplemental Schedule 1 for a schedule of funding progress.)	\$13,851,411,411	\$13,519,997,946	\$131,614,285	\$147,310,894	\$515,803	\$532,274	\$13,983,541,499	\$13,667,841,114
<b>The accompanying notes are an integral part of these financial statements.</b>								



KENTUCKY TEACHERS' RETIREMENT SYSTEM

**Statement of Changes in Plan Net Assets  
For the Years Ended June 30, 2006 and 2005**

	Defined Benefit Plan		Medical Insurance Plan		403(b) Tax Shelter		TOTAL	
	2006	2005	2006	2005	2006	2005	2006	2005
<b>ADDITIONS</b>								
Contributions								
Employer	\$410,920,969	\$388,346,438	\$89,319,498	\$79,022,562			\$500,240,467	\$467,369,000
Member	258,464,856	247,024,518	51,697,167	51,576,031			310,162,023	298,600,549
<b>Total contributions</b>	669,385,825	635,370,956	141,016,665	130,598,593	0	0	810,402,490	765,969,549
Other Contributions								
Recovery income			118,419				118,419	
Medicare D receipts			5,999,560				5,999,560	
<b>Total other contributions</b>			6,117,979				6,117,979	
Investment Income								
Net Appreciation/(Depreciation) in FV of Investments	282,572,648	512,314,384					282,572,648	512,314,384
Interest	255,566,732	242,566,500	6,804,286	6,507,537	\$ 21,454	\$ 11,479	262,392,472	249,085,516
Dividends	153,566,960	162,040,978					153,566,960	162,040,978
Rental Income, Net	30,949,900	33,121,604					30,949,900	33,121,604
Securities Lending, Gross Earnings	28,464,668	18,152,354					28,464,668	18,152,354
<b>Gross Investment Income</b>	751,120,908	968,195,820	6,804,286	6,507,537	21,454	11,479	757,946,648	974,714,836
Less Investment Expense	(6,156,584)	(4,670,256)					(6,156,584)	(4,670,256)
Less Securities Lending Expense	(27,656,322)	(17,455,008)					(27,656,322)	(17,455,008)
Net Investment Income	717,308,002	946,070,556	6,804,286	6,507,537	21,454	11,479	724,133,742	952,589,572
<b>Total additions</b>	1,386,693,827	1,581,441,512	153,938,930	137,106,130	21,454	11,479	1,540,654,211	1,718,559,121
<b>DEDUCTIONS</b>								
Benefits	1,035,606,281	963,371,539			37,925	39,877	1,035,644,206	963,411,416
Refunds of contributions	12,834,222	10,975,941	5,143	9,072			12,839,365	10,985,013
Insurance expenses			165,006,322	142,349,436			165,006,322	142,349,436
Administrative expense	6,839,859	6,652,673	4,624,074	4,070,892			11,463,933	10,723,565
<b>Total deductions</b>	1,055,280,362	981,000,153	169,635,539	146,429,400	37,925	39,877	1,224,953,826	1,127,469,430
<b>Net increase (decrease)</b>	331,413,465	600,441,359	(15,696,609)	(9,323,270)	(16,471)	(28,398)	315,700,385	591,089,691
<b>Net assets held in trust   for pension &amp; post   employment healthcare   benefits</b>								
<b>Beginning of year</b>	13,519,997,946	12,919,556,587	147,310,894	156,634,164	532,274	560,672	13,667,841,114	13,076,751,423
<b>Ending of year</b>	<u>\$13,851,411,411</u>	<u>\$13,519,997,946</u>	<u>\$131,614,285</u>	<u>\$147,310,894</u>	<u>\$515,803</u>	<u>\$532,274</u>	<u>\$13,983,541,499</u>	<u>\$13,667,841,114</u>

***The accompanying notes are an integral part of these financial statements.***

**Notes to Financial Statements  
Years Ended June 30, 2006 and 2005**

**Note 1: Description of Plan**

**A. REPORTING ENTITY**

The Teachers' Retirement System of the State of Kentucky (KTRS) was created by the 1938 General Assembly and is governed by Chapter 161 Section 220 through Chapter 161 Section 990 of the Kentucky Revised Statutes (KRS). KTRS is a blended component unit of the Commonwealth of Kentucky and therefore is included in the Commonwealth's financial statements. KTRS is a cost-sharing multiple-employer defined benefit plan established to provide pension benefit plan coverage for local school districts and other public educational agencies in the state.

**B. PARTICIPANTS**

As of June 30, 2006 a total of 199 employers participated in the plan. Employers are comprised of 176 local school districts, 17 Department of Education Agencies and other educational organizations, 5 universities and also the Kentucky Community and Technical College System.

According to KRS 161.220 " . . . any regular or special teacher, or professional occupying a position requiring certification or graduation from a four (4) year college or university . . . " is eligible to participate in the System. The following illustrates the classifications of members:

	<u>2006</u>	<u>2005</u>
Active contributing members:		
Vested	41,656	40,799
Non-vested	32,084	31,482
Inactive members, vested	4,275	4,033
Retirees and beneficiaries currently receiving benefits	<u>38,497</u>	<u>37,402</u>
Total members, retirees, and beneficiaries	116,512	113,716

**C. BENEFIT PROVISIONS**

Members become vested when they complete five (5) years of credited service. To qualify for monthly retirement benefits, payable for life, members must either:

- 1.) Attain age fifty-five (55) and complete five (5) years of Kentucky service, or
- 2.) Complete 27 years of Kentucky service.

*Note 1: Description of Plan continued . . .*

Participants that retire before age 60 with less than 27 years of service receive reduced retirement benefits. Non-university members receive monthly payments equal to two (2) percent (service prior to July 1, 1983) and two and one-half (2.5) percent (service after July 1, 1983) of their final average salaries for each year of credited service. University employees receive monthly benefits equal to two (2) percent of their final average salary for each year of credited service. The final average salary is the member's five (5) highest annual salaries except members at least 55 with 27 or more years of service may use their (3) three highest annual salaries. New members (including second retirement accounts started) after July 1, 2002 will receive monthly benefits equal to 2% of their final average salary for each year of service if, upon retirement, their total service is less than ten years. New members after July 1, 2002 who retire with ten or more years of total service will receive monthly benefits equal to 2.5% of their final average salary for each year of service, including the first ten years. In addition, members who retire July 1, 2004 and later with more than 30 years of service will have their multiplier increased for all years over 30 from 2.5% to 3.0% to be used in their benefit calculation.

The system also provides disability benefits for vested members at the rate of sixty (60) percent of the final average salary. A life insurance benefit, payable upon the death of a member, is \$2,000 for active contributing members and \$5,000 for retired or disabled members.

Cost of living increases are one and one-half (1.5) percent annually. Additional ad hoc increases, and any other benefit amendments must be authorized by the General Assembly.

<p><b>Note 2: Summary of Significant Accounting Policies</b></p>
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**A. BASIS OF ACCOUNTING**

The financial statements are prepared on the accrual basis of accounting. Member contributions and employer matching are recognized in the fiscal year due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

**B. CASH**

KTRS has three cash accounts. At June 30, 2006, the pension cash account totaled \$7,406,251; the administrative expense fund cash account was \$1,902,091; and the life insurance cash account totaled \$320,956; therefore, the carrying value of cash was \$9,629,298 and the corresponding bank balance was \$12,307,142. The variance is primarily due to outstanding checks and items not processed by the bank on June 30, 2006.

**C. CAPITAL ASSETS**

Fixed assets are recorded at historical cost less straight-line accumulated depreciation. The classes of fixed assets are furniture and equipment, the KTRS office buildings and land. Furniture and equipment are depreciated over an average useful life of five to seven years. The office buildings are depreciated over forty years.

*Note 2: Summary of Significant Accounting Policies continued . . .*

**D. INVESTMENTS**

Plan investments are reported at fair value. Fair value is the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Short-term securities are carried at cost, which approximates fair value. Fixed income and common and preferred stocks are generally valued based on published market prices and quotations from national security exchanges and securities pricing services. Real estate is primarily valued based on appraisals performed by independent appraisers.

Purchase and sales of debt securities, equity securities, and short-term investments are recorded on the trade date. Real estate equity transactions are recorded on the settlement date. Upon sale of investments, the difference between sales proceeds and cost is reflected in the statement of changes in plan net assets.

Investment expenses consist of investment manager and consultant fees along with fees for custodial services.

**E. COMPENSATED ABSENCES**

Expenses for accumulated vacation days and compensatory time earned by the System's employees are recorded when earned. Upon termination or retirement, employees of the system are paid for accumulated vacation time limited to 450 hours and accumulated compensatory time limited to 200 hours. As of June 30, 2006 and 2005 accrued compensated absences were \$601,135 and \$604,988.

**F. RISK MANAGEMENT**

Destruction of assets, theft, employee injuries and court challenges to administrative policy are among the various risks to which the system is exposed. In order to cover such risks the system carries appropriate insurance policies such as fire and tornado, employee bonds, fiduciary liability, worker's compensation and equipment insurance.

**G. OTHER RECEIVABLES**

KTRS now allows qualified purchases of service credit to be made by installment payments not to exceed a five-year period. Revenue is recognized in the initial year of the installment contract agreement. The June 30, 2006 and 2005 installment contract receivables were \$734,673 and \$946,714.

**H. USE OF ESTIMATES**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**I. INCOME TAXES**

The defined benefit plan is organized as a tax-exempt retirement plan under the Internal Revenue Code. The tax sheltered annuity plan is no longer continued and will be fully terminated when all lifetime annuities have expired. The system's management believes that it has operated the plans within the constraints imposed by federal tax law.

*Note 2: Summary of Significant Accounting Policies continued . . .*

**J. ACCOUNTING CHANGES**

The system opted for early implementation of GASB #44 Economic Condition Reporting: The Statistical Section as of June 30, 2005. See the statistical section for these disclosures.

<p><b>Note 3: Contributions and Reserves</b></p>
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**A. CONTRIBUTIONS**

Contribution rates are established by Kentucky Revised Statutes. Members are required to contribute 9.855% of their salaries to the System. University members are required to contribute 8.375% of their salaries. KRS 161.580 allows each university to reduce the contribution of its members by 2.215%; therefore, university members contribute 6.16% of their salary to KTRS.

The Commonwealth of Kentucky is required to contribute 13.105% of salaries for its non-university members and 13.84% of salaries for university members.

The member and employer contributions consist of pension contributions and post-retirement contributions. The post-retirement contribution .75% finances KTRS' retiree medical insurance plan.

If an employee leaves covered employment before accumulating five (5) years of credited service, accumulated employee contributions plus interest are refunded to the employee upon the member's request.

**B. RESERVES**

Member Reserve

This fund was established by KRS 161.420(2) as the Teacher Savings Fund and consists of contributions paid by university and non-university members. The fund also includes interest authorized by the Board of Trustees from Unallocated Reserves. The accumulated contributions of members that are returned upon withdrawal or paid to the estate or designated beneficiary in the event of death are paid from this fund. Upon retirement, the member's contributions and the matching state contributions are transferred from this fund to Benefit Reserves, the fund from which retirement benefits are paid.

Employer Reserve

This fund was established by KRS 161.420(3) as the State Accumulation Fund and receives state appropriations to the Retirement System. The state matches an amount equal

to members' contributions. State appropriations during the year are based on estimates of members' salaries. At year-end when actual salaries are known, the required state matching is also realized by producing either a receivable from or a payable to the State of Kentucky. While fiscal years 2006 and 2005 resulted in over-appropriations from the state a receivable is still due from the state because prior years under-appropriations have not been paid.

Benefit Reserve

This fund was established by KRS 161.420(4) as the Allowance Reserve Fund, the source for retirement, disability, and survivor benefits paid to members of the System. These benefits are paid from the retired members' contributions until they are exhausted, at which time state matching contributions are used to pay the benefits. After an individual member's contributions and the state matching contributions have been exhausted, retirement benefits are paid from monies transferred from Unallocated Reserves.

Unallocated Reserve

This fund was established by KRS 161.420(6) as the Guarantee Fund to collect income from investments, state matching contributions of members withdrawn from the System, and state matching contributions for cost of living adjustments (COLAs). In addition, it receives money for which disposition is not otherwise provided. This fund provides interest to the other funds, benefits in excess of both members' and state matching contributions, monies for administrative expenses of the System, and deficiencies not covered by the other funds.

Administrative Expense Reserve

This fund was established by KRS 161.420(1) as the Expense Fund. Investment income transferred to this fund from Unallocated Reserves is used to pay the administrative expenses of the System.

Life Insurance Reserve

This fund was established pursuant to the provisions of KRS 161.655 to provide a life insurance benefit to retired and active members of the Kentucky Teachers' Retirement System. This benefit is financed by KTRS employer contributions that are actuarially determined.

**Note 4: Deposits With Financial Institutions and Investments  
(Including Repurchase Agreements)**

**A. LEGAL PROVISIONS FOR INVESTMENTS**

The following disclosures are meant to help the users of KTRS' financial statements assess the risks KTRS takes in investing public funds. The Board of Trustees and the Investment Committee are guided by asset allocation parameters that the Board approves through its powers defined in KRS 161.430. The parameters as outlined in Title 102, Chapter 1.175, Section 2 of the Kentucky Administrative Regulations are as follows:

- ⊆ There shall be no limit on the amount of investments owned by the System that are guaranteed by the U.S. Government.
- ⊆ Not more than thirty-five percent (35%) of the assets of the System at book value shall be invested in corporate debt obligations.
- ⊆ Not more than sixty percent (60%) of the assets of the System at book value shall be invested in common stocks or preferred stocks. Not more than twenty-five percent (25%) of the assets of the System at book value shall be invested in a stock portfolio designed to replicate a general, United States stock index.
- ⊆ Not more than ten percent (10%) of the assets of the System at book value shall be invested in real estate. This would include real estate equity, real estate lease agreements, mortgages on real estate that are not guaranteed by the U.S. Government, and shares in real estate investment trusts.
- ⊆ Not more than one percent (1%) of the assets of the System at book value shall be invested in venture capital investments, providing at least seventy-five percent (75%) of such investments must be in-state.
- ⊆ Not more than ten percent (10%) of the assets of the System book value shall be invested in any additional category or categories of investments. The Board of Trustees shall approve by resolution such additional category or categories of investments. Within this parameter, to further diversify the portfolio, the Board approved provisions that permit the limited ownership of both foreign equities and timberland.

**B. CASH AND CASH EQUIVALENTS**

For cash deposits and cash equivalents, custodial credit risk is the risk that, in the event of a bank failure, the retirement system's deposits may not be returned to the system. The System's total bank balance at June 30, 2006 was \$12,307,142, of which \$3,945,250 primarily represents deposited amounts due the System for which actual funds are in transit to and waiting to be received by the custodial bank; therefore, these funds were unavailable for investment. An additional amount of \$1,902,091 represents funds held in the bank but their

*Note 4: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .*

investment is controlled by the Commonwealth of Kentucky. The remaining bank balance amount of \$6,459,802 was the amount invested in cash equivalents. Cash equivalents are created through the daily sweeps of available excess cash by the System's custodial bank into bank sponsored short-term investment funds. These funds are custodial bank sponsored commingled funds which are invested in short-term securities backed by the U.S. Government and its agencies. The actual cash deposits held in bank accounts are insured up to \$100,000 as covered by federal depository insurance and uncollateralized until being invested in cash equivalents.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

- a. uncollateralized,
- b. collateralized with securities held by the pledging financial institution, or
- c. collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

As of June 30, 2006 the System's cash equivalents in the amount of \$6,459,802 were not exposed to custodial credit risk since this amount was invested by the custodial bank and collateralized at 102% with the collateral pledged to the Treasurer of the Commonwealth of Kentucky.

### C. INVESTMENTS

All of the System's assets are invested in short-term and long-term debt (bonds and mortgages) securities, equity securities, and real estate. These assets are reported at fair market value.

Investments are governed by the Board of Trustees' policy while the Board of Trustees and the Investment Committee shall execute their fiduciary responsibilities in accordance with the "prudent person rule", as identified in KRS 161.430 (2)(b). The prudent person rule establishes a standard for all fiduciaries, to act as a prudent person would be expected to act, with the "care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims".

The following chart represents the fair market values of the investments of the Kentucky Teachers' Retirement System for June 30, 2006.



## KENTUCKY TEACHERS' RETIREMENT SYSTEM

Note 4: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

<b>Schedule of Investments</b>		
	June 30, 2006	June 30, 2005
<b>Short Term Investments</b>		
Repurchase Agreements	\$ 794,300,000	\$ 1,287,800,000
Total Short Term Investments	\$ 794,300,000	\$ 1,287,800,000
<b>Bonds and Mortgages</b>		
U.S. Government Obligations		
Treasury Notes & Bonds	\$ 1,032,439,779	\$ 1,224,201,754
Agencies	1,039,092,693	1,150,974,690
GNMA (Single Family)	18,781,578	39,496,335
Other Miscellaneous	<u>168,353,243</u>	<u>130,140,221</u>
Total U.S. Government Obligations	\$ 2,258,667,293	\$ 2,544,813,000
Corporate Bonds		
Industrial	\$ 542,410,465	\$ 591,007,453
Finance	1,023,985,966	886,000,915
Utility Bonds (Except Telephone)	119,160,317	112,350,505
Telephone Bonds	<u>46,512,518</u>	<u>80,660,662</u>
Total Corporate Bonds	\$ 1,732,069,266	\$ 1,670,019,535
Other Fixed Income Investments		
FHA and VA Single Family Mortgages	\$ 1,904	\$ 6,526
Project Mortgages (FHA & GNMA)	13,687,213	18,317,771
State and Local Government Issues	<u>180,776,223</u>	<u>36,634,480</u>
Total Other Investments	\$ 194,465,340	\$ 54,958,777
Total Bonds and Mortgages	\$ 4,185,201,899	\$ 4,269,791,312
Stocks	\$ 8,531,993,656	\$ 7,612,197,454
Real Estate	<u>387,193,796</u>	<u>386,004,453</u>
Total Investments	\$ 13,898,689,351	\$ 13,555,793,219
<i>This Schedule does not include \$856,631,934 securities lending collateral.</i>		

### Custodial Credit Risk

**Custodial Credit Risk** for an investment is the risk that, in the event of the failure of counterparty, the pension trust fund will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the retirement system, and are held by either:

- a. the counterparty or
- b. the counterparty's trust department or agent, but not in the System's name.

*Note 4: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .*

The cash reserve of the System is maintained in high quality short-term investments. Commercial paper, U.S. Treasury and agency obligations, certificates of deposit, banker's acceptances, and repurchase agreements are all permissible investments. The System utilized investment instruments it regards as the most secure and having the best returns and does not use short-term investments that finance foreign businesses unless they are issued and guaranteed by the United States Government.

Individual repurchase agreements are ordered by KTRS under the terms of Master Repurchase Agreements with various brokers under terms dictated by KTRS. The repurchase agreements and their supporting collateral are held by the custodial agent's correspondent bank in an account identified by the custodian's name and KTRS's nominee name. This account is unique to KTRS. The Master Repurchase Agreements require that the supporting collateral have a market value of at least 102% of the value of the repurchase agreements.

In addition to the System's \$13.9 billion in investments at June 30, 2006, cash collateral reinvestment securities acquired through securities lending by the System's custodian, whom is also the lending agent/counterparty amounted to \$856,631,934. This is consistent with the System's securities lending agreement with the custodian. (Please refer to a following section entitled Securities Lending.)

Interest Rate Risk

Interest Rate Risk on investments is the possibility that changes in interest rates will reduce the fair value of the retirement System's investments. In general, the longer the period until an investment matures, the greater the negative impact that changes in interest rates can have on fair value.

As of June 30, 2006 KTRS had the following investments and weighted average maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Average Maturity (years)</u>
U.S. Treasuries	\$ 1,065,908,866	10.6
Agencies	1,039,092,693	10.0
Corporate Bonds	1,732,069,266	8.3
Mortgage Pass-Throughs	32,470,695	21.9
State & Local Govt Issues	180,776,223	13.4
Collateralized Mortgage Obligations	<u>134,884,156</u>	<u>21.6</u>
Totals	\$ 4,185,201,899	10.1

## KENTUCKY TEACHERS' RETIREMENT SYSTEM

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Note 4: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

In addition to the above securities, Repurchase Agreements (short-term investments) had a total fair value of \$794,300,000 average maturity of 5.8 days. Average maturity is used as a measure of a security's exposure to interest rate risk due to fluctuations in market interest rates. Mortgage pass-throughs and collateralized mortgage obligations are typically amortizing investments with an average life and interest rate risk, significantly less than suggested by the legal maturity. Mortgage-backed securities, which are generally pre-payable, and other callable bonds are subject to adverse changes in average life in response to market interest rate changes. The preceding schedule reflects only the legal maturity of all such bonds.

The System does not have a formal investment policy that limits investment maturities as a means of managing its exposure to potential fair value losses arising from future changes in interest rates. Market or interest rate risk is the greatest risk faced by an investor in the debt securities market. The price of a debt security typically moves in the opposite direction of the change in interest rates. Mortgages held by the System are fixed interest rate mortgages.

Collateralized mortgage obligations (CMOs) are bonds that are collateralized by whole loan mortgages, mortgage pass-through securities or stripped mortgage-backed securities. Income is derived from payments and prepayments of principal and interest generated from collateral mortgages. Cash flows are distributed to different investment classes in accordance with a CMO's established payment order. The System held \$134.9 million in CMOs as of June 30, 2006.

Asset-backed securities (ABS) are bonds or notes backed by loan paper or accounts receivable originated by banks, credit card companies, or other credit providers. The originator of the loan or accounts receivable paper sells it to a specially created trust, which repackages it as securities. ABSs have been structured as pass-throughs and as structures with multiple bond classes. The ABSs held by the system and reported in the corporate bond category above are moderately sensitive to changes in interest rates.

### Credit Risk

Credit risk is the risk that an issuer or counterparty to an investment will not fulfill its obligations. The following schedule lists KTRS's investments according to credit ratings as of June 30, 2006:

<u>RATING</u>	<u>FAIR VALUE</u>
Repurchase Agreements	\$ 794,300,000
Agency	1,207,379,658
AAA	556,659,829
AA	506,148,069
A	697,167,296
BBB	139,535,548
BB	24,175,953
Total	\$ 3,925,366,353

*Note 4: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .*

Total market value of the fixed income portfolio was \$4,979,501,899 on June 30, 2006. In addition to the above investments, there were securities owned totaling \$1,054,135,546 in U.S. Treasury Issues, which are obligations of the U.S. Government. The rating system used in the chart is the nationally recognized Standard and Poor's rating system. The credit risk associated with repurchase agreements and Agency investments is very minimal as the general rating of these securities is higher than AAA. Notation is made that the ratings of securities is subject to change due to circumstances and thereby may have a lower rating than when first purchased.

The System's policy on credit rating as stated in 102 KAR 1:175 is that:

"A fixed income investment shall be rated at the time of purchase within the four (4) highest credit classifications identified by one (1) of the major rating services. A private placement debt investment shall be subject to the same credit qualifications as each fixed income investment. Notwithstanding the foregoing, the fixed income investment portfolio as a whole shall maintain an average rating equal to at least the second highest credit classification."

#### Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Losses from credit risk are heightened if a significant portion of resources are invested with a single issuer. Per Administrative Regulation 102 KAR 1:175, the System is subject to the following policies regarding single issuers of fixed income and equity securities:

"Unless the issuer is the United States Government or one (1) of its agencies, the amount invested in the securities of a single issuer shall not equal more than five (5) percent of the assets of the system at book value."

"The System's position in a single stock shall not exceed two (2) percent of the System's assets at book value. The system's position in a single stock shall not exceed five (5) percent of the outstanding stock for that company unless the investment is part of a venture capital program approved by the Board of Trustees or the Investment Committee."

KTRS has not invested greater than five percents (5%) of the System's assets at book value in any single issuer and is in compliance with the System's policies as stated here.

#### Foreign Currency Risk

As of June 30, 2006, KTRS had no exposure to foreign currencies.

Any stocks held associated with foreign interest are American Depositary Receipt (ADR) investments which are securities that are issued by a U.S. bank in place of the foreign stock shares held in trust by that bank, thereby facilitating the trading of foreign shares in U.S. markets. ADRs are denominated in U.S. currency.

## KENTUCKY TEACHERS' RETIREMENT SYSTEM

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Note 4: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .

The System's policy regarding foreign equities is that "Not more than 10% of the assets of the System at book value shall be invested in any additional category or categories of investments....Within this parameter, to further diversify the portfolio, the Board approved provisions that permit the limited ownership of both foreign equities and timberland."

### D. SECURITIES LENDING

Section 161.430 of the Kentucky Revised Statutes empowers the Board of Trustees with complete fiduciary responsibility for the funds of the System. The System operates a securities lending program in which it temporarily lends securities to qualified agents in exchange for a net fee and high quality collateral. U.S. Government and agency securities and selected domestic stocks and bonds are the types of securities that are lent. The System's sub-custodian, The Bank of New York, acts as lending agent in exchanging securities for collateral. The collateral has a value of not less than 102% of the market value of the lent securities plus any accrued, unpaid distributions. The collateral may consist of cash, marketable U.S. Government securities, and select marketable U.S. Government agency securities approved by the System.

Securities lending transactions are accounted for in accordance with GASB Statement No. 28 Accounting and Financial Reporting for Securities Lending Transactions, which established standards of accounting and financial reporting for securities lending transactions. The following section details the net income earned from securities lending for the fiscal year ended June 30, 2006:

<u>ITEM</u>	<u>EARNINGS</u>
Gross Earnings (Interest and fees)	\$ 28,464,668
Less: Gross Borrower Rebates	27,315,764
Bank Fees	340,558
Other	0
Net Earnings	<u>\$ 808,346</u>

## FINANCIAL SECTION

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*Note 4: Deposits With Financial Institutions and Investments (Including Repurchase Agreements) continued . . .*

Cash collateral is invested in short-term obligations fully guaranteed by the United States Government or select Government agencies and Government Repurchase Agreements with qualified agents. The System cannot pledge or sell collateral securities received unless the borrower defaults. The lending agent (Bank of New York) also indemnifies the System from any financial loss associated with a borrower's default and collateral inadequacy. As of June 30, 2006 the loan maturity was one day and the weighted average maturity of cash collateral investments was one day.

At fiscal year end, the System has no credit risk exposure to borrowers, since the amounts the System owes the borrowers exceeds the amounts the borrowers owe the System and there were no losses resulting during the period.

Security lending programs can entail interest rate risk and credit risk. The System minimizes interest rate risk by limiting the term of cash collateral investments to several days. The credit risk is controlled by investing cash collateral in securities with qualities similar to the credit worthiness of lent securities.

The following table presents the fair values of the underlying securities, and the value of the collateral pledged at June 30, 2006:

Type of Security Lent	Fair Value	Cash Collateral Received Non-Cash Collateral Value*
U.S. Government and Agencies	\$ 548,168,691	\$ 556,988,665
U.S. Equities	294,729,093	299,643,269
TOTAL	\$ 842,897,784	\$ 856,631,934

*\*Represents value of cash collateral only. Loan or margin collateral requirements met via the use of non-cash collateral (e.g. Government securities or Letters of Credit) are excluded from these values.*

**Note 5: Medical Insurance Plan & Post-Employment Benefits**

**A. PLAN DESCRIPTION**

In addition to the required pension benefits described in Note 1, Kentucky Revised Statute 161.675 allows KTRS to provide post-retirement healthcare benefits to members and dependents. To be eligible for medical benefits, the member must have retired either for service or disability, attain age 55 with 5 years of Kentucky service or had 27 years of Kentucky service.

The KTRS self-insured plan is limited to KTRS members and spouses at least the age of 65. All KTRS members under the age of 65 are offered commercial insurance through a state insurance purchasing pool administered by the Kentucky Personnel Cabinet. The Personnel Cabinet's primary function is to negotiate contracts with health plans to obtain the best price for persons covered. KTRS members were given a supplement to be used for payment of their health insurance premium. The amount of the member's supplement was based on the member's service credit and age. Premiums over the monthly supplement are paid by the member. The system bears no risk for excess claims expenses under the commercial insurance coverage.

KTRS members and spouses at least age 65 in the KTRS self-insured plan are also given a supplement based on service credit. Members with 20 or more years of service received the highest supplement.

At June 30, 2006, KTRS insurance covered 30,601 retirees and 6,520 dependents.

**B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Accounting

The Medical Insurance Plan financial statements are prepared using the accrual basis of accounting. Member contributions and employer matching are recognized in the fiscal year due. Healthcare premiums charged to retired members are recognized when due and any premiums collected in advance are recognized as a liability.

Method Used to Value Investments

Since the investments are all short-term investments they are reported at cost, which approximates fair value.

**C. CONTRIBUTIONS**

The post-retirement healthcare provided by KTRS is financed on a pay-as-you-go basis. In order to fund the post-retirement healthcare benefit, one and five tenths percent (1.5%) of the gross annual payroll of all active members is contributed. One-half (1/2) of this amount is

*Note 5: Medical Insurance Plan & Post-Employment Benefits continued . . .*

derived from member contributions and one-half (1/2) from state appropriation. Also, the premiums collected from retirees as described in the plan description help meet the medical expenses of the plan.

Since medical expenses have skyrocketed in the last decade, it has become increasingly difficult to meet the expenses of the retiree health insurance program. To fund the plan, the state legislature has directed Medical Insurance Stabilization Funding of \$62,294,800 and \$29,169,700 for fiscal years 2006 and 2005 respectively. These amounts are to be repaid to the System's guarantee fund from the State's general fund over a 10 year period per KRS 161.553.

**D. INCURRED BUT NOT REPORTED CLAIMS LIABILITIES**

July 1, 1991 KTRS became self-insured assuming all liability for post-retirement healthcare costs. Effective January 1, 1997, insurance plan participants under age 65 were offered insurance through a state purchasing pool. KTRS recognizes estimates of liabilities for self-insured unpaid claims that have incurred (both reported and unreported) using the development method. This method uses past observed patterns of time between the date the claim is incurred and the date the claim is paid to estimate incurred claims from available paid claim information. The following schedule shows the change in the claims and liability and the claims activity for the years ended June 30, 2006 and 2005.

	Fiscal Year 2006	Fiscal Year 2005
Beginning Unpaid Claims Liability	\$ 8,312,898	\$ 5,798,772
Claims Incurred		
Current Year	166,148,844	140,105,734
Increase (Decrease) in Prior Years	(1,142,811)	2,243,702
Total Incurred Claims	\$ 165,006,034	\$ 142,349,436
Claims Paid		
Current Year	\$ 160,549,717	\$ 133,632,780
Prior Years	5,188,476	6,202,530
Total Payments	\$ 165,738,193	\$ 139,835,310
Ending Unpaid Claims Liability	\$ 7,580,738	\$ 8,312,898

**E. ADMINISTRATIVE EXPENSES**

The total administrative expenses of \$4,624,074 are processing fees paid to third party administrators.



**Note 6: 403(b) Tax-Sheltered Annuity Plan**

**A. PLAN DESCRIPTION**

KTRS has, in prior years, administered a salary deferral program as permitted by section 403(b) of the Internal Revenue Code. Under this program members were able to voluntarily defer a portion of their compensation within the limits established by the applicable laws and regulations. However, the System's Board of Trustees determined that the cost of providing the necessary services to assure the System of continuing compliance with these laws and regulations was not economically feasible due to the limited participation in the program by the System's members. The Board decided, therefore, to discontinue offering the program as of April 30, 1997. Members who were not receiving annuities from their account as of April 30, 1997, were able to transfer their respective accounts directly into other tax-sheltered plans on a tax-free basis. As of June 30, 2006, the thirty-two members who are receiving annuities will continue to receive distributions according to the terms of their respective elections.

**B. SUMMARY OF SIGNIFICANT POLICIES**

Basis of Accounting

The Tax-sheltered Annuity Plan financial statements are prepared using an accrual basis of accounting. Contributions are no longer being accepted into the plan, therefore, there are no receivables to be recognized.

Method Used to Value Investments

The short-term investments are reported at cost, which approximates fair value.

**Note 7: Pension Plan for Employees of the System**

Full-time employees of Kentucky Teachers' Retirement System (KTRS) participate in either KTRS or Kentucky Employees Retirement System. Both plans are multiple-employer cost sharing defined benefit pension plans. All KTRS employees in positions requiring a four-year degree are covered under KTRS. The contribution rates and required employer matching are the same as state agency employers in the system. These rates, the plan description and funding policy are fully disclosed in the notes to the financial statements.

The System's annual required contributions for KTRS employee members for the fiscal years 2006, 2005, and 2004 were \$368,662, \$355,095, and \$359,370 respectively. KTRS contributed 100% of the required contribution each year.

All other KTRS employees are covered under the Kentucky Employee Retirement System (KERS) in the Non-Hazardous Employees Pension Plan. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to

*Note 7: Pension Plan for Employees of the System continued ...*

beneficiaries of plan members under certain circumstances. Per KRS 61.565(3), contribution rates shall be determined by the Board on the basis of an annual actuarial valuation. Rates may be amended by the Board as needed. The System's administrative budget and employer contribution rates are subject to the approval of the Kentucky General Assembly. Employee contribution rates are set by the statute and may be changed only by the Kentucky General Assembly.

Members of KERS were required to contribute 5% of their annual creditable compensation for the fiscal years 2006, 2005, and 2004. As the employer, KTRS is required to contribute the annual actuarially determined rate of the creditable compensation. The actuarial rate for the fiscal years 2006, 2005, and 2004 was 5.89%; and the System's annual required contributions to KERS were \$103,137, and \$268,975, and \$123,483 respectively. KTRS contributed 100% of the required contributions for each year.

KERS issues a publicly available financial report that may be obtained by writing Kentucky Retirement System, 1260 Louisville Road, Frankfort, Kentucky 40601-6124.

<b>Required Supplementary Schedules</b>
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<b>Required Supplemental Schedule                      Defined Benefit Plan                      Schedule of Funding Progress                      (dollar amounts in millions)</b>						
VALUATION YEAR JUNE 30	ACTUARIAL VALUE OF ASSETS	ACTUARIAL ACCRUED LIABILITIES	UNFUNDED ACTUARIAL ACCRUED LIABILITIES (UAAL)	FUNDED RATIO	COVERED PAYROLL	UAAL AS A % OF COVERED PAYROLL
	<b>a</b>	<b>b</b>	<b>(b-a)</b>	<b>(a/b)</b>	<b>c</b>	<b>[(b-a)/c]</b>
2001	\$ 13,299.2	\$ 14,642.1	\$ 1,342.9	90.8%	\$ 2,213.8	60.7%
2002	13,588.8	15,695.6	2,106.8	86.6	2,313.7	91.1
2003	13,863.8	16,594.8	2,731.0	83.5	2,497.7	109.3
2004	14,255.1	17,617.6	3,362.5	80.9	2,641.5	127.3
2005	14,598.8	19,134.8	4,536.0	76.3	2,703.4	167.8
2006	14,857.6	20,324.7	5,467.1	73.1	2,859.5	191.2

The amounts reported in this schedule of funding progress do not include assets or liabilities for post-employment healthcare benefits, nor are the assets and liabilities of the tax-sheltered annuity plan included.

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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**Required Supplemental Schedule  
Defined Benefit Plan  
Schedule of Employer Contributions  
(dollar amounts in millions)**

FISCAL YEAR ENDED JUNE 30	ANNUAL REQUIRED CONTRIBUTIONS	PERCENTAGE CONTRIBUTED
2001	\$ 262.8	100 %
2002	284.8	100
2003	322.0	100
2004	364.4	100
2005	383.8	100
2006	406.1	100

**Required Supplemental Schedule  
Medical Insurance Plan  
Schedule of Funding Progress  
(dollar amounts in millions)**

VALUATION YEAR JUNE 30	ACTUARIAL VALUE OF ASSETS	ACTUARIAL ACCRUED LIABILITIES	UNFUNDED ACTUARIAL ACCRUED LIABILITIES (UAAL)	FUNDED RATIO	COVERED PAYROLL	UAAL AS A % OF COVERED PAYROLL
<b>a</b>	<b>b</b>	<b>(b-a)</b>	<b>(a/b)</b>	<b>c</b>	<b>[(b-a)/c]</b>	
2001	\$ 103.4	\$ 2,531.0	\$ 2,427.6	4.1%	\$ 2,213.8	109.7%
2002	146.0	2,806.0	2,660.0	5.2	2,313.7	115.0
2003	165.5	2,886.0	2,720.5	5.7	2,497.7	108.9
2004	158.9	3,166.6	3,007.7	5.0	2,641.5	113.9
2005	147.3	4,763.9	4,616.6	3.1	2,703.4	170.8
2006	131.6	4,341.9	4,210.3	3.0	2,859.5	147.2

The amounts reported in this schedule of funding progress do not include assets or liabilities for the defined benefit plan, nor are the assets and liabilities of the tax-sheltered annuity plan included.

<b>Required Supplemental Schedule Medical Insurance Plan Schedule of Employer Contributions (dollar amounts in millions)</b>		
FISCAL YEAR ENDED JUNE 30	ANNUAL REQUIRED CONTRIBUTIONS	PERCENTAGE CONTRIBUTED
2001	\$ 92.4	100%
2002	95.3	100
2003	77.2	100
2004	53.3	100
2005	79.0	100
2006	89.3	100

### **Notes to Required Supplementary Information**

#### **Note 1: Description of Schedule of Funding Progress**

##### Defined Benefit Plan

The schedule of Funding Progress summarizes the actuarial value of the System's assets and actuarial accrued liability as of June 30, 2006, and each of the preceding five years. The data presented in the schedule were obtained from the System's independent actuary's annual valuation report for each year presented.

Expressing the actuarial value of assets as a percentage of the actuarial accrued liabilities provides an indication whether the system is becoming financially stronger or weaker. Generally, the greater the percentage the stronger the retirement system. Trends in unfunded actuarial accrued liabilities and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liabilities as a percentage of annual covered payroll aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage the stronger the retirement system.

##### Medical Insurance Plan

The schedule of Funding Progress summarizes the actuarial value of the System's assets and actuarial accrued liability as of June 30, 2006 and each of the preceding five years. The data presented in the schedule were obtained from the System's independent actuary's annual valuation report for each year presented.

Expressing the actuarial value of assets as a percentage of the actuarial accrued liabilities provides an indication whether the system is becoming financially stronger or weaker. Generally, the greater the percentage the stronger the plan. Trends in unfunded actuarial accrued liabilities and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liabilities as a percentage of annual covered payroll aids analysis of progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage the stronger the plan.

**Note 2: Actuarial Methodologies and Assumptions**

**DEFINED BENEFIT PLAN**

**A. Methodologies**

The promised benefits of the System are included in the actuarially calculated contribution rates, which are developed using the unit credit actuarial cost method with projected benefits. The actuarial value of assets was determined using the method illustrated in the Actuarial Value of Assets table. Gains and losses are reflected in the unfunded accrued liability that is being amortized by regular annual contributions as a level percentage of payroll within a 30-year period using an open amortization approach. The five (5) year smoothed market approach is used for asset valuation.

<b>Actuarial Value of Assets</b>		
(1)	Actuarial Value of Assets on June 30, 2005	\$ 14,598,842,537
(2)	Market Value End of Year June 30, 2006	13,783,830,173
(3)	Market Value Beginning of Year June 30, 2005	13,456,025,741
(4)	Cash Flow	
	a. Contributions	664,572,122
	b. Benefit Payments	1,037,706,643
	c. Net	(373,134,521)
(5)	Investment Income	
	a. Market total: (2) - (3) - (4)c	700,938,953
	b. Assumed rate	7.5%
	c. Amount for Immediate Recognition [(1) x (5)b] + [(4)c*(5)b*0.5]	1,080,920,646
	d. Amount for Phased-in Recognition (5)a - (5)c	(379,981,693)
(6)	Phased-in Recognition of Investment Income	
	a. Current Year: 0.20*(5)d	(75,996,339)
	b. First Prior Year	(23,843,540)
	c. Second Prior Year	(349,147,545)
	d. Third Prior Year	0
	e. Fourth Prior Year	0
	f. Total Recognized Investment Gain	(448,987,424)
(7)	Actuarial Value End of Year June 30, 2006 (1) + (4)c + (5)c + (6)f	14,857,641,238
(8)	Difference Between market & Actuarial Values (2) - (7)	(1,073,811,065)

**B. Assumptions**

Significant actuarial assumptions employed by the actuary for the funding purposes as of June 30, 2006, the most recent updated actuarial information include:

* Assumed inflation rate	4.0%
* Assumed investment rate	7.5%
* Assumed projected salary increases	4.0% - 8.2%
* Assumed post retirement benefit increase	1.5%

*Note 2: Actuarial Methodologies and Assumptions continued . . .*

**MEDICAL INSURANCE PLAN**

**A. Methodologies**

The actuarial value of assets is determined by using the market value as provided by KTRS. Compliance with applicable current or future accounting standards may require use of different actuarial methods or assumptions. For purposes of estimating the amortization, a 4.0% salary scale is used.

**B. Assumptions**

Significant actuarial assumptions employed by the actuary for the funding purposes as of June 30, 2006, the most recent updated actuarial information include:

Investment Rate of Return*	7.50%
Healthcare cost trend rate*	
Initial Pre-Medicare trend rate	11.50%
Initial Post-Medicare trend rate	11.30%
Ultimate Pre-Medicare trend rate	5.00%
Year of Ultimate Pre-Medicare trend rate	2013
Ultimate Post-Medicare trend rate	5.00%
Year of Ultimate Post-Medicare trend rate	2012
<i>*Includes inflation at</i>	4.00%

**Supporting Schedule 1**  
Schedule of Administrative Expenses  
Year Ended June 30, 2006

<b>ADMINISTRATIVE EXPENSES</b>	<b>YEAR ENDED JUNE 30, 2006</b>
Salaries	\$ 4,890,745
Other Personnel Costs	446,613
Professional Services & Contracts	229,853
Utilities	66,842
Rentals	17,143
Maintenance	74,460
Postage & Related Services	351,646
Printing	151,241
Insurance	77,020
Miscellaneous Services	98,899
Telecommunications	27,493
Computer Services	47,975
Supplies	49,906
Depreciation	141,629
Travel	41,871
Dues & Subscriptions	26,128
Miscellaneous Commodities	7,187
Furniture, Fixtures, & Equipment not Capitalized	97,061
Compensated Absences	<u>(3,853)</u>
<b>TOTAL ADMINISTRATIVE EXPENSES</b>	<b>\$ 6,839,859</b>

**Supporting Schedule 2**

Schedule of Contracted Investment Management Expenses  
Year Ended June 30, 2006

<b>BALANCED MANAGER</b>		
Todd Investment Advisors	\$	1,125,000
<b>FIXED INCOME MANAGERS</b>		
Galliard Capital Management		313,207
<b>EQUITY MANAGERS</b>		
GE Asset Management Inc.	\$	647,328
UBS Global Asset Management Corporation		970,000
Wellington Management Company,LLP		2,501,832
<b>Total Equity Managers</b>		4,119,160
<b>CUSTODIAN</b>		
Farmers Bank		492,668
<b>CONSULTANT</b>		
Becker, Burke Associates		65,000
<b>TOTAL CONTRACTED INVESTMENT MANAGEMENT EXPENSES</b>	<b>\$</b>	<b>6,115,035</b>

**Supporting Schedule 3**

Schedule of Professional Fees for Year Ended June 30, 2006

PROFESSIONAL	NATURE OF SERVICE	YEAR ENDED JUNE 30, 2006
Charles T. Mitchell Company, LLP	Auditing Services	\$ 28,000
Cavanaugh Macdonald Consulting	Actuarial Services	172,860
Reed, Weitkamp, Schell & Vice, PLLC	Attorney Services	3,080
Farmers Bank	Banking Services	15,755
International Claim Specialist	Investigative Services	10,158
	<b>TOTAL</b>	<b>\$ 229,853</b>



**Charles T. Mitchell Company, LLP**

**Certified Public Accountants**

WILLIAM G. JOHNSON, JR., C.P.A.  
JAMES CLOUSE, C.P.A.  
BERNADETTE SMITH, C.P.A.  
KIM FIELD, C.P.A.  
GREG MIKLAVCIC, C.P.A.

**Consultants**

CHARLES T. MITCHELL, C.P.A.  
DON C. GILES, CPA



201 WEST MAIN, P.O. BOX 698  
FRANKFORT, KENTUCKY 40602-0698  
TELEPHONE (502) 227-7395  
TELECOPIER (502) 227-8005  
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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Trustees  
Teachers' Retirement System of the State of Kentucky  
Frankfort, Kentucky

We have audited the general purpose financial statements of Teachers' Retirement System of the State of Kentucky, 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 December 5, 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 Teachers' Retirement System of the State of Kentucky's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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 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. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

**Compliance**

As part of obtaining reasonable assurance about whether Teachers' Retirement System of the State of Kentucky's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 test disclosed no instances on noncompliance that are required to be reported under Government Auditing Standards.

This report is intended for the information of the audit committee, management, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

*Charles T. Mitchell Co.*

December 5, 2006

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# INVESTMENT SECTION

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for Fiscal Year ending June 30, 2006

**REPORT ON INVESTMENT ACTIVITY**

This report is prepared by the Investment staff of the Kentucky Teachers' Retirement System.

**Mr. Paul L. Yancey, CFA**  
Chief Investment Officer

**Mr. Philip L. Webb**  
Director of Investment Accounting

**OVERVIEW**

The Board of Trustees of the Teachers' Retirement System annually appoints an Investment Committee consisting of two Board members and the Executive Secretary. This Committee acts on behalf of the Board, subject to its approval, in all matters concerning investments. In compliance with the Kentucky Revised Statutes, the Board of Trustees has adopted an "Investment Policy" which it reviews periodically. The investment objectives of the Board of Trustees are as follows:

1. The funds of the Teachers' Retirement System of the State of Kentucky shall be invested solely in the interest of its members and their beneficiaries. Investment income shall be used for the exclusive purpose of providing benefits to the members and their beneficiaries and making payment of reasonable expenses in administering the Plan and its Trust Funds.
2. The specific objective of the investment program shall be the investment of the Fund's assets in securities which shall provide a reasonable rate of total return with major emphasis being placed upon the protection of the invested assets. When investments are acquired, current income together with prospects for capital appreciation shall be weighed in regard to the long range needs of providing benefits to members and their beneficiaries. Short term fluctuations in the market value of the Fund's assets shall be considered as secondary to the long-term objectives and needs of the System.

Within the Kentucky Revised Statutes and pertinent policies, the Board of Trustees and the Investment Committee shall execute their fiduciary responsibilities in accordance with the "prudent man rule", as identified in KRS 161.430 (2)(b). Investment activities shall be conducted, "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims". The responsibility for investing the assets of the System is clearly assigned to the Board of Trustees.

<b>INVESTMENT COMMITTEE</b>	
MR. ARTHUR W. GREEN <i>Chairman</i>	MR. ROBERT M. CONLEY <i>Vice-Chairman</i>
MR. GARY L. HARBIN, CPA <i>Ex-Officio Member, Executive Secretary</i>	
<b>EXECUTIVE INVESTMENT STAFF</b>	
MR. GARY L. HARBIN, CPA <i>Executive Secretary</i>	MR. PAUL L. YANCEY, CFA <i>Chief Investment Officer</i>

**PROFESSIONAL CONSULTANTS**

**Investment Advisors**

**Fixed Income and Equity Managers**

Todd Investment Advisors  
101 South Fifth Street  
National City Towers, Suite 3160  
Louisville, Kentucky 40202

**Fixed Income Manager**

Galliard Capital Management  
800 LaSalle Avenue  
Suite 2060  
Minneapolis, Minnesota 55502

**Equity Managers**

UBS Global Asset Management  
UBS Tower  
One North Wacker Drive  
Chicago, Illinois 60606

Wellington Management Company  
75 State Street  
Boston, Massachusetts 02109

GE Asset Management  
3001 Summer Street  
Stamford, Connecticut 06904

**Investment Consultant**

Becker, Burke Associates, Inc.  
Suite 1000  
221 North LaSalle Street  
Chicago, Illinois 60601

**Investment Consultant/Subcustodian**

Farmers Bank and Capital Trust Co.  
Farmers Bank Plaza  
Frankfort, Kentucky 40601

The Bank of New York  
One Wall Street  
New York, New York 10286

**INVESTMENT CONSULTANT'S STATEMENT**

Becker, Burke Associates served as Investment Consultant to the Kentucky Teachers' Retirement System during the 2005-06 fiscal year as it has in several previous years. Becker, Burke Associates is familiar with the operation of the System's investment program as well as its performance. The investment program of the Retirement System is operated in a prudent manner that reflects a desire to preserve capital while maximizing returns. The assets of the Retirement System are assigned to various portfolios in order to diversify the System's investments and take advantage of opportunities in various asset classes and sectors. The System gravitates toward relatively conservative holdings in each asset class. The overall effect of diversification is to minimize risk. The manner in which the Retirement System operates and its investment results are commensurate with other risk-averse institutional investors in similar regulatory environments.



Edmund M. Burke  
President  
Becker, Burke Associates  
September 22, 2006

## ASSET ALLOCATION

The Board of Trustees and the Investment Committee are guided by asset allocation parameters that the Board approves through its powers defined in KRS 161.430. The asset allocation limits complement the investment principles used by the Board and Committee regarding security, diversification, high return, and liquidity. The asset allocation policy is adopted by the Board of Trustees and approved in the form of administrative regulation. The asset allocation parameters are structured in order to maximize return while at the same time provide a prudent diversification of assets and preserve the capital of the Teachers' Retirement System. The Board is interested in assuming secure investments that will provide long term growth to the fund. The Board does not arbitrarily compromise security in order to enhance the prospects of return. The Investment Committee and the Board are mindful of the fund's liquidity and its capability of meeting both short and long term obligations. Asset allocation parameters follow:

1. There will be no limit on the amount of investments owned by the System that are guaranteed by the U.S. Government.
2. Not more than 35% of the assets of the System at book value shall be invested in corporate debt obligations.
3. Not more than 60% of the assets of the System at book value shall be invested in common stocks or preferred stocks. No more than 25% of the assets of the System at book value shall be invested in a stock portfolio designed to replicate a general, U.S. stock index.
4. Not more than 10% of the assets of the System at book value shall be invested in real estate. This would include real estate equity, real estate lease agreements, mortgages on real estate that are not guaranteed by the U.S. Government, and shares in real estate investment trusts.
5. Not more than 10% of the assets of the System at book value shall be invested in any additional category or categories of investments. The Board shall approve by resolution such additional category or categories of investments. Within this parameter, to further diversify the portfolio, the Board approved provisions that permit the limited ownership of foreign equities, timberland, and private equity.

The asset allocation of investments at market value was somewhat different at the beginning of the fiscal year than it was on June 30, 2006. In addition, the market value allocation of assets through the dynamics of the securities markets is different than the book value allocations. During the 2005-06 fiscal year, the market value of the stock position increased from 56% of assets the previous year to 61% of assets. The portion of the portfolio in Government securities decreased from 19% to 16%. The cash position decreased during the year to 5.7% of assets. The real estate equity position remained a relatively small portion of the System's portfolio at approximately 3%.

The Kentucky Revised Statutes require the Board of Trustees to employ experienced investment counselors to advise it on investment related matters. Todd Investment Advisors was employed during 2005-06 as the System's principal investment counselor, providing assistance in the management of \$2.9 billion of stocks and bonds. UBS Global Asset Management, Wellington Management Company, Galliard Capital Management, and GE Asset Management also were retained during the 2005-06 fiscal year to provide investment counseling services. Galliard Capital Management assisted in the management of approximately \$878 million in bonds. GE Asset Management managed about \$599 million in equity investments. UBS Global Asset

Management was responsible for managing approximately \$1.1 billion in equities, and Wellington Management Company managed about \$1.1 billion in equities. In addition to monitoring the investment counselors, the in-house investment staff managed about \$7.2 billion of fixed income and equity assets. All of the investment firms, while specializing in particular asset classes or sectors, are required to work within the same broad objectives, portfolio constraints, and administrative guidelines. Five investment counselors plus an in-house staff provide the Board of Trustees with a diversification of management that is appropriate for a \$13.9 billion fund. The Farmers Bank & Capital Trust Company, located in Frankfort, Kentucky, was retained in 2005-06 as the Custodian of Securities with the Bank of New York serving as a sub-custodian.

The System regularly votes proxy statements associated with its equity ownership. The positions assumed by the System are intended to represent the financial interests of the membership. The Board of Trustees has adopted a policy that directs the staff not to subjugate the financial concerns of the System to social or political protests. At the same time, the System expects the companies in which it acquires stock to be solid corporate citizens that abide by Federal, state, and local laws.

## FINANCIAL ENVIRONMENT

In the fiscal year ended June 30, 2006, economic growth and corporate profits remained healthy and equities generally produced respectable, if unspectacular, returns. Clearly, the market was battling the headwinds of rising interest rates and energy prices. The market admirably absorbed the blow of Hurricane Katrina in late summer 2005 and a spike in natural gas prices into the following fall and winter. Steadily rising short-term interest rates and oil prices were a more persistent problem, however. Overall, the S&P 500 Index returned 8.6% for the fiscal year, with those returns a bit concentrated in the energy sector, which returned 12.8%.

Over the fiscal year, gross domestic product, adjusted for inflation, grew at a healthy 3.5% pace. Industrial production rose 4.5%. Jobs continued to be created at a relatively strong pace, with the unemployment rate falling from 5.0% to 4.6%. This underlying economic strength supported the market through most of the fiscal year. Countervailing trends restraining the economy and equity prices grew as the year went on, however.

Chief among these restraining influences was the price of energy. The initial blow of Hurricane Katrina and other storms in late August and September, 2005, crippled the Gulf Coast energy infrastructure. Oil prices surged from \$56.50 per barrel on June 30, 2005 to about \$70 at the time of Hurricane Katrina, before falling back below \$60 later in the fall. Natural gas futures spiked from under \$8 per contract at the beginning of the fiscal year to a high of \$15.38 in December before falling back below \$8 by late winter. While the natural gas spike was sharp, but temporary, oil prices resumed their climb, finishing the fiscal year at \$73.93 per barrel. Oil prices were up 31% for the fiscal year.

The other key restraining influence on the economy and equity market was rising interest rates. The Federal Reserve raised the short-term federal funds rate methodically in eight quarter-point increments, from 3.25% to 5.25%. The Federal Reserve's goal was to control inflationary pressures. The Consumer Price Index was up 4.3% over the fiscal year, or 2.6% excluding food and energy. Over the previous twelve months the Consumer Price Index had risen 2.5%, or 2.0% excluding food and energy.

In this environment, the strongest industry sector within the S&P 500 over the fiscal year was energy (+ 12.8%). Also doing well were telecommunications (+ 11.8%) and industrials (+ 6.0%). The weakest sector was information technology (-6.2%), followed by health care (-4.6%).

Smaller companies generally outperformed the largest companies, with the S&P 400 Mid Cap Index returning 13.0% and the S&P 600 Small Cap Index returning 13.9% versus 8.6% for the Large Cap S&P 500 Index . By quarter, the S&P 500 returned 3.6% in the first quarter of the fiscal year, 2.1% in the second quarter, 4.2% in the third quarter, and -1.4% in the final quarter, ended June 30, 2006. In typical fashion, smaller companies generally outperformed during rising markets and underperformed in falling markets. By early 2006, small and mid cap stocks had outperformed large cap stocks for over six years. That is an extended period for such a trend, indicating that a shift in favor of large caps may be due.

Value stocks generally outperformed growth stocks, particularly among large cap stocks. In the large cap arena, the Russell 1000 Value Index was up 12.1% for the fiscal year versus 6.1% for the Russell 1000 Growth Index. In mid caps, the Russell Mid Cap Value Index returned 14.3% versus 13.0% for the Russell Mid Cap Growth Index. Among small caps the differential disappeared, with both the Russell 2000 Value Index and Russell 2000 Growth Index returning 14.6%. The value/growth performance differential was clearly correlated with industry sector performance. The energy, telecommunications, and industrial sectors, which are considered low growth or value sectors, performed well. The growth industries of information technology and health care performed poorly.

By the final quarter of the fiscal year, it was becoming clear that the cumulative effect of sustained high energy prices and rising interest rates was taking a toll on the economy. Adjusted for inflation, retail sales in June, 2006 were up only 1.6% over a year earlier. Housing starts in June were 11% below a year earlier. Employment growth had clearly slowed, from a monthly average growth of 179,000 in the quarter ended December, 2005 to a monthly average of 112,000 in the quarter ended June, 2006. The equity market responded with a weak quarter. The S&P 500 was down 1.4% for the quarter, while the Mid Cap 400 was down 3.1% and the Small Cap 600 was down 4.6%.

At the end of the fiscal year the economy continued to grow, albeit at a slowing pace. After its interest rate hike in late June, the Federal Reserve acknowledged the incipient slowdown in its statement and indicated that future policy would depend upon future economic developments. Key issues facing the equity market going forward were whether the Federal Reserve had successfully engineered a slowdown to a sustainable, non-inflationary growth rate, and whether oil prices would continue to rise.

## **FIXED INCOME MARKET**

Going into the fiscal year, the prospects were not bright for returns in the fixed income market. In the U.S. Treasury market, yields ranged from about 3.1% on the shortest instruments to 4.2% on thirty-year bonds. The economy was strong, inflationary pressures were rising, largely due to surging oil prices, and the Federal Reserve was steadily raising short-term interest rates with no near-term end in sight. By the end of the fiscal year, yields were at or above 5% across the Treasury maturity spectrum. Yields steadily rose through the year and prices of existing fixed rate bonds fell. The Lehman Government/Credit Index produced a total return of -1.52% for the fiscal year.

The Federal Reserve raised the federal funds rate in eight quarter-point increments--at each regularly scheduled meeting--from 3.25% at the beginning of the fiscal year to 5.25% in late June, 2006. The cumulative effect of this was to cause a further "flattening" of the yield curve, with short-term rates rising more than long-term rates. While short-term rates rose two full percentage points over the year, the yield on the thirty-year Treasury bond rose only one percentage point, from 4.2% to 5.2%. By the end of the fiscal year, the yield curve was slightly "inverted", with some short-

term rates higher than longer-term rates. Such an inversion is often a harbinger of economic weakness in the foreseeable future. Right on cue, in its statement raising the federal funds rate to 5.25%--above longer-term rates--the Federal Reserve recognized developing economic weakness and indicated that future policy would depend upon developments. Two years of automatic increases were over.

As yields rose and the term structure flattened, the only real refuge in the investment grade bond market was shorter maturities. Though yields rose less on long-term bonds, they still posted worse returns due to their greater price sensitivity to yield increases. Within the Lehman Government/Credit Index, one-to-three year bonds returned +1.93% while bonds longer than ten years returned -6.47%. Across maturities, investment grade corporate bonds returned -2.22% compared to -1.68% for U.S. Treasury bonds. Fixed rate mortgage securities held up relatively well in the rising rate environment, with a total return of 0.39%. Below investment grade bonds were the best performing sector in the fiscal year, with the Lehman High Yield Index returning 4.8%.

By the summer of 2006, it was becoming increasingly clear that the relatively strong economic growth of the past twelve months was softening. Notably, the housing market was weakening. Existing home sales in June were 8.2% below a year earlier and a rising inventory of unsold homes was putting downward pressure on values. Retail sales were weakening, with a heavily indebted consumer sector under increasing pressure from rising gasoline prices. Employment growth showed clear signs of weakening. Though inflationary pressures stoked by increases in oil and other commodities had yet to abate, inflation typically starts to decline only several months after the economy begins to weaken. The overall environment appeared to be one in which interest rates were unlikely to rise much further in the near term.

At the end of the fiscal year, the outlook for fixed income was better than a year earlier, but mixed. Yield levels were above 5% in the Treasury market and above 6% in lower quality investment grade corporate bonds and mortgages. The Federal Reserve appeared to be at or near the end of its campaign of short-term interest rate hikes. On the other hand, the markets continued to provide historically thin levels of yield compensation for credit risk and a slowing economy threatened to cause credit deterioration down the road. In addition, leveraged buyouts of public companies by private equity investors were bringing about sudden credit deterioration in corporate bonds with increasing frequency. By all indications, this trend would only increase. If one could avoid potential credit landmines in the future, the prospects were improving for a return to more normal inflation-adjusted bond returns.

## **PORTFOLIO CHARACTERISTICS**

At year's end, the System's entire stock portfolios, exclusive of the stock index fund and the international portfolio, could be characterized as high quality and diversified. The KTRS portfolio, as measured by beta, was approximately as risky as the Standard & Poor's 500 Index. Beta is a measure of the volatility in price of a particular stock or portfolio compared to the volatility of the index. The beta of the KTRS portfolio at the end of the fiscal year was 1.03. The KTRS portfolio registered a price-earnings multiple that was higher than the index. The price-earnings ratio for the portfolio at the end of the fiscal year was 17.0, compared to 16.84 for the index. Two factors attesting to the high quality of the portfolio were the high rate of growth in both earnings per share and dividends per share. The average earnings growth rate over the past five years for the KTRS stock portfolio was 18.4%. The average dividend growth rate for the past five years of the KTRS portfolio was 15.2%. At the end of the 2005-06 fiscal year, the yield level for the KTRS portfolio stood at 1.89%, which was slightly higher than the index's yield of 1.85%.



The stock position, apart from the stock index fund and the international portfolio, began the 2005-06 fiscal year by being 31.4% of assets at market value, and by year-end, it constituted 31.9% of assets. In dollars, the value of the stock position increased from approximately \$4.3 billion to about \$4.4 billion in 2005-06. The three stock index funds represented another \$3.8 billion that was invested in stocks at year end, while \$320 million was invested in an international portfolio. At the end of 2005-06, the sector weightings in the KTRS stock portfolio were similar to those of the Standard & Poor's 500 Index. The greatest differences were underweightings by KTRS in the consumer staples and energy sectors and overweightings in the consumer discretionary, health care, and information technology sectors.

On June 30, 2006, the System's entire bond portfolio had a duration of 5.1 years. The average coupon rate for the holdings was 5.5%. As of June 30, 2006, the average maturity of the fixed income portfolio was 7.7 years. The maturities of fixed income investments will generate cash for the fund in future years. Approximately 74% of the fixed income investments, including short term cash equivalents, will mature by the end of 2018, about 12 years. This will assist the System in meeting retirement fund obligations as well as permit it to assume new investments.

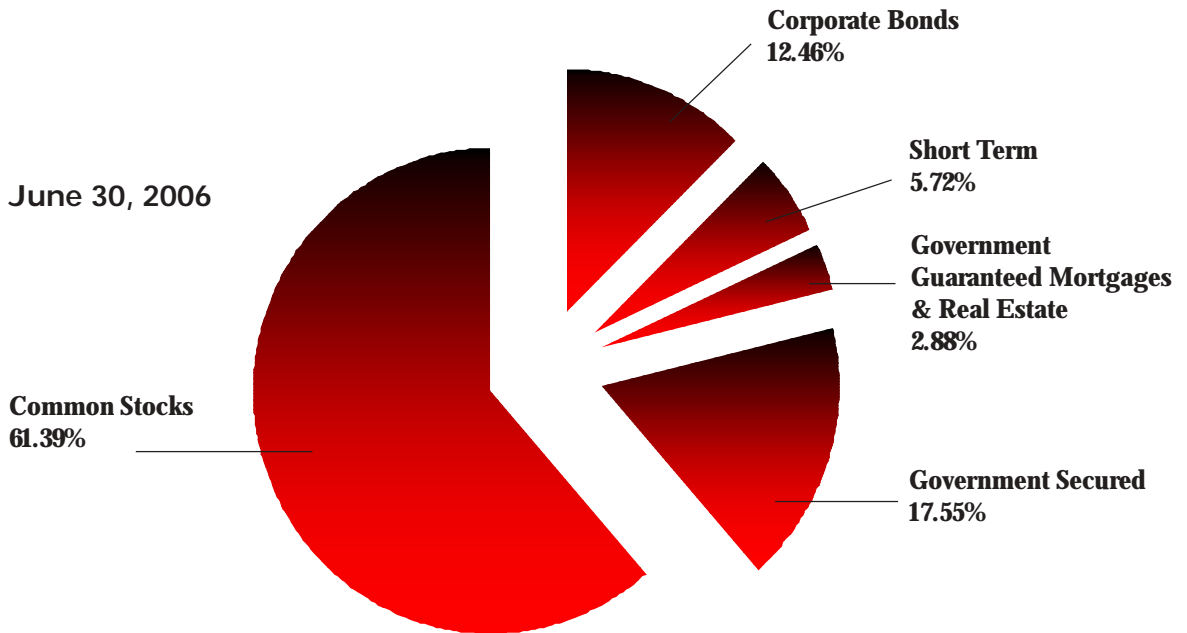
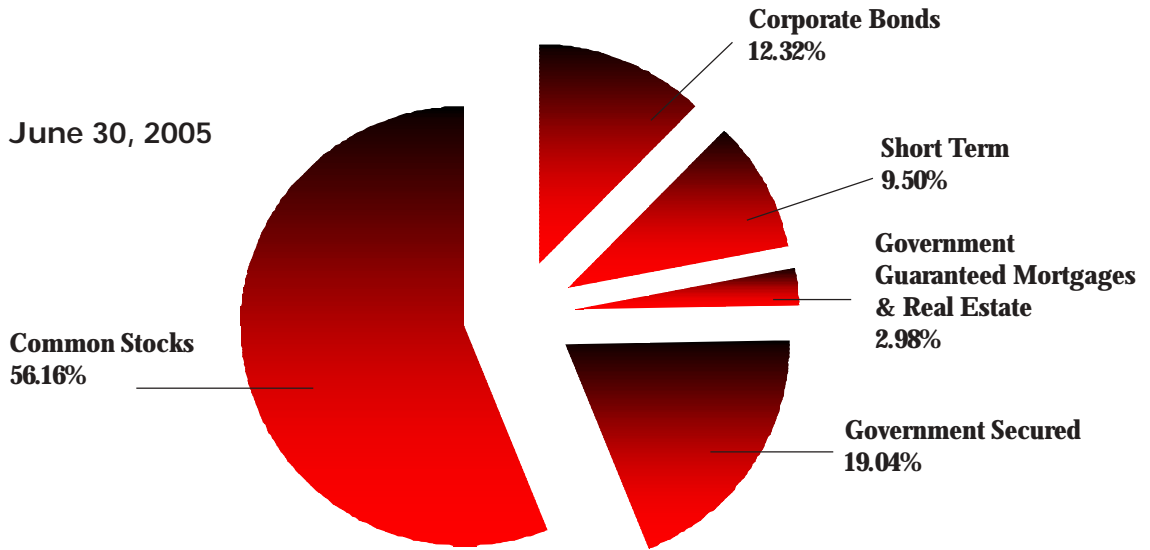
### **PORTFOLIO RETURNS**

The investment portfolio experienced growth in book values and its market value during the 2005-06 year. The market value of the portfolio increased \$342.9 million to a total of \$13.9 billion at year-end. The book value of the fund increased \$262.9 million during the year. The System accumulated in excess of \$651 million of investment income during 2005-06; this investment income total excludes monies earned but not received by the end of the fiscal year. The income resulted from interest, dividends, rental income, lending income, and gains.

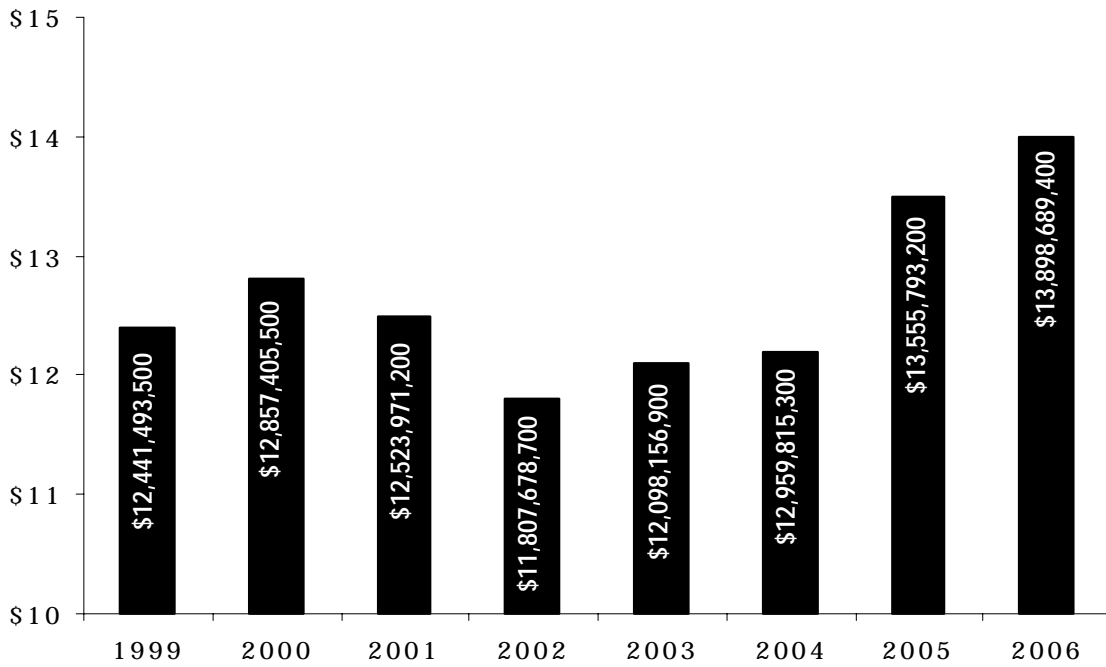
For the 2005-06 fiscal year, the total return earned by the System's stock position is higher than the return generated by the Standard & Poor's 500 Stock Index. The KTRS stock position earned a total return of 9.0% in 2005-06, while the stock index earned 8.6%. The ten year annualized return for the years 1997 through 2006 was 8.9% for the System's stock position and 8.3% for the stock index. The System's bond position earned a ten year annualized total return of 6.4%. This is slightly higher than the 6.2% return earned by the Lehman Government/Credit High Quality Index. In 2005-06, the System's bonds earned a total return of (1.2)%, while the Lehman High Quality Index earned (1.4)%. The entire portfolio earned a total return of 5.4% in 2005-06. The portfolio's ten year annualized rate of total return was 7.5%. The total return of the portfolio over ten years more than kept up with the rate of inflation and provided real growth. In 2005-06, the Consumer Price Index registered an inflation rate of 4.3%. The ten year annualized rate is 2.6%. The System's returns were generated by the CRA Rogers Casey performance reporting system using a time-weighted rate of return calculation based upon the modified Dietz methodology.

The charts that follow this narrative graphically display the growth that is discussed in the preceding paragraphs. Following the charts is a summary description of investments held at June 30, 2006. The System annually produces a detailed investment report that is available on request.

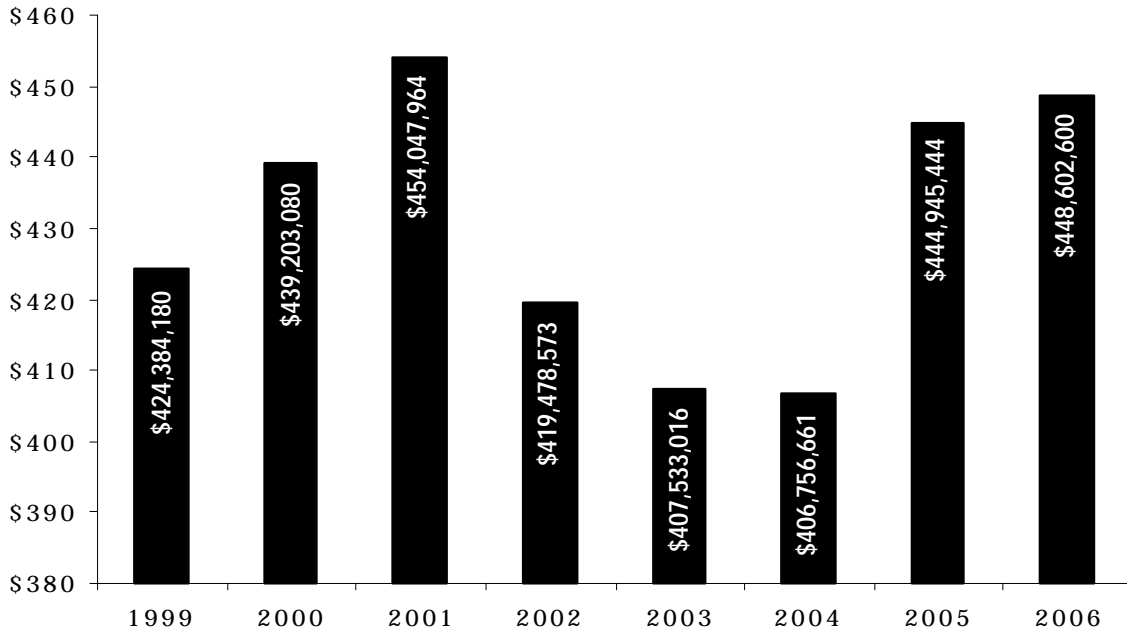
**Distribution of Investments  
Market Values**



**Investment Portfolio Growth**  
Market Values



**Investment Income Growth**  
Excludes Amortization  
Excludes Net Gains



INVESTMENT SECTION

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**Total Return on KTRS Investments\*  
Percentages**

Fiscal Year	Standard & Poor's 500 Index	KTRS Stocks	Lehman Govt./Credit High Quality Index	KTRS Bonds	Consumer Price Index	KTRS Cash Collection Fund	KTRS Real Estate	KTRS Total Portfolio
1996-97	34.7	33.1	7.6	7.8	2.3	5.8	8.8	19.6
1997-98	30.2	29.2	11.3	11.6	1.7	6.1	9.7	19.4
1998-99	22.8	22.0	2.7	2.3	2.0	5.3	9.7	11.5
1999-00	7.3	3.6	4.6	4.9	3.7	5.8	9.9	4.1
2000-01	(14.8)	(8.9)	11.0	10.9	3.3	6.0	9.5	(0.7)
2001-02	(18.0)	(14.5)	8.6	9.5	1.1	2.5	6.0	4.1
2002-03	0.3	(1.1)	12.3	12.4	2.1	1.5	9.3	4.8
2003-04	19.1	19.2	(1.2)	(0.7)	3.2	1.0	9.7	9.7
2004-05	6.3	7.9	7.0	7.6	2.5	2.3	9.6	7.5
2005-06	8.6	9.0	(1.4)	(1.2)	4.3	5.0	11.3	5.4
Three Year Annualized Rate	11.2	11.8	1.4	1.8	3.3	2.8	10.2	7.5
Five Year Annualized Rate	2.5	3.5	4.9	5.4	2.6	2.4	9.2	4.6
Eight Year Annualized Rate	3.0	4.0	5.3	5.6	2.8	3.7	9.4	4.7
Ten Year Annualized Rate	8.3	8.9	6.2	6.4	2.6	4.1	9.3	7.5
Fifteen Year Annualized Rate	10.7	11.1	6.9	7.1	2.7	4.3	9.2	8.6
Twenty Year Annualized Rate	11.0	11.1	6.0	7.5	3.1	---	---	8.8

\* The performance calculations presented above were generated by the CRA Rogers Casey Performance reporting system using a time-weighted rate of return calculation based upon the Dietz methodology.

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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**Investment Summary  
Fair Market Value  
06/30/2006**

Type of Investment	Fair Value 07/01/05	Acquisitions	Appreciation (Depreciation)	Sales Redemptions, Maturities & Paydowns	Fair Value 06/30/06
Short Term	1,287,800,000	45,489,990,100	1,350,900	45,984,841,000	794,300,000
Fixed Income	4,269,791,300	2,047,313,100	(274,273,400)	1,857,629,100	4,185,201,900
Equities	7,998,201,900	2,537,319,200	555,495,200	2,171,828,800	8,919,187,500
<b>TOTAL</b>	<b>13,555,793,200</b>	<b>50,074,622,400</b>	<b>282,572,700</b>	<b>50,014,298,900</b>	<b>13,898,689,400</b>

**Contracted Investment Management Expenses  
(\$ Thousands) as of 06/30/2006**

	Assets Under Management	Expenses	Basis Points *
<b>INVESTMENT MANAGER FEES</b>			
Fixed Income Managers	\$ 878,422	\$ 313	3.6
Equity Managers	2,869,234	4,119	14.4
Balanced Manager	2,912,421	1,125	3.9
<b>TOTALS</b>	<b>\$ 6,660,077</b>	<b>\$ 5,557</b>	<b>8.3</b>
<b>OTHER INVESTMENT SERVICES</b>			
Custodian Services	\$ 13,898,689	\$ 493	0.4
Investment Consultant		65	
<b>TOTAL</b>		<b>\$ 558</b>	
<b>GRAND TOTAL</b>		<b>\$ 6,115</b>	<b>4.4</b>

\* One basis point is one-hundredth of one percent or the equivalent of .0001.

## Transaction Commissions

06/30/2006

COMPANIES	SHARES TRADED	COMMISSIONS	COMMISSION PER SHARE
ADVEST INC	664,600	26,584.00	0.0400
B TRADE SERVICES	91,445	457.23	0.0050
BANC OF AMERICA	8,202,731	397,811.81	0.0485
BASS TRADING	19,000	760.00	0.0400
BEAR STEARNS	727,880	30,612.70	0.0421
BENCHMARK COMPANY	1,600	64.00	0.0400
BLAIR, WILLIAM & CO (IPO)	1,100	1,210.00	1.1000
BNY BROKERAGE	1,369,498	56,257.92	0.0411
BOENNING & SCATTERGOOD	197,430	4,505.17	0.0228
C E UNTERBERG TOWBIN	36,400	15,396.44	0.4230
C S FIRST BOSTON (IPO)	2,300	2,311.20	1.0049
CANACCORD ADAMS	15,400	659.00	0.0428
CANTOR FITZGERALD & CO	117,100	5,195.00	0.0444
CHAPDELAINE PENSION	37,700	1,508.00	0.0400
CIBC OPPENHEIMER WORLDMARKET	372,200	13,196.00	0.0355
CITIGROUP	4,761,556	191,780.44	0.0403
COLLINS STEWART INC	7,000	280.00	0.0400
COWAN & CO	224,675	14,962.60	0.0666
CREDIT SUISSE SEC LLC	2,981,874	120,214.86	0.0403
CROWELL WEEDON & CO	73,170	2,926.80	0.0400
CUTTONE & COMPANY	6,200	155.00	0.0250
DEUTSCHE BANK SECURITIES	1,102,360	52,897.60	0.0480
DOWLING & PARTNERS	35,800	1,432.00	0.0400
E-TRADE CAPITAL MARK	47,600	1,904.00	0.0400
EURO BROKERS	14,200	426.00	0.0300
FIDELITY CAPITAL MARKETS	17,000	510.00	0.0300
FIRST KY SEC	1,120,600	44,824.00	0.0400
FOX PITT KELTON INC	99,900	3,996.00	0.0400
FREIDMAN BILLINGS	86,800	3,365.00	0.0388
FTN FINANCIAL CAPITAL	92,800	3,712.00	0.0400
FULCRUM GLOBAL PARTNERS	18,000	720.00	0.0400
GOLDMAN SACHS & CO	4,250,828	173,001.99	0.0407
HARRIS NESBITT GERAR	31,300	1,410.00	0.0450
HEFLIN & CO	146,400	5,856.00	0.0400
HOWE BARNES INVESTMENT	70,400	2,816.00	0.0400
HSBC SECURITIES	13,600	648.00	0.0476
INSTINET	86,200	918.25	0.0107
INVESTMENT TECHNOLOGY GROUP	22,396,109	364,789.12	0.0163
ITG TRANSITIONS TRADE	30,782,552	230,869.24	0.0075
ISI GROUP	1,783,600	71,344.00	0.0400
J J B HILLIARD W L LYONS	2,148,174	85,926.96	0.0400
JEFFERIES & CO	2,891,616	112,850.06	0.0390
JMP SECURITIES	5,900	236.00	0.0400
JONES & ASSOCIATES	155,800	6,232.00	0.0400
JP MORGAN & CHASE	391,000	17,519.00	0.0448
KEEFE BRUYETTE & WOODS	42,300	3,039.80	0.0719
KEYBANC CAPITAL MARKETS	27,800	2,174.00	0.0782
KNIGHT EQUITY MARKETS	321,400	11,210.00	0.0349
KOENIG SECURITIES	1,000	25.00	0.0250
KV EXECUTION SERVICES	163,330	3,114.25	0.0191
LAZARD FRERES & CO	3,716,308	148,652.32	0.0400

Year Ended June 30, 2006

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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*Transaction Commissions continued . . .*

COMPANIES	SHARES TRADED	COMMISSIONS	COMMISSION PER SHARE
LEERINK SWANN & CO	32,900	1,328.50	0.0404
LEGG MASON WOOD WALKER	1,082,586	43,303.44	0.0400
LEHMAN BROTHERS	5,215,639	127,989.55	0.0245
LEXINGTON INVESTMENT CO	1,413,095	56,523.80	0.0400
LIQUIDNET INC	1,683,590	33,671.80	0.0200
MERRILL LYNCH	9,895,008	356,333.69	0.0360
MOORS & CABOT	12,400	496.00	0.0400
MORGAN KEEGAN	1,873,696	74,947.84	0.0400
MORGAN STANLEY/DEAN WITTER	5,661,596	186,521.51	0.0329
MURPHY & DURIEU	110,000	2,599.25	0.0236
NEEDHAM & CO INC	200	8.00	0.0400
NYFIX TRANSACTION SERVICES	107,100	535.50	0.0050
OPPENHEIMER & CO	55,200	2,208.00	0.0400
OTA LIMITED PARTNERS	43,110	1,724.40	0.0400
PIPELINE TRADING	142,500	2,137.50	0.0150
PRUDENTIAL SECURITIES	249,510	10,733.20	0.0430
PULSE TRADING	41,000	922.50	0.0225
R W BAIRD	31,200	1,248.00	0.0400
RAYMOND JAMES & ASSOCIATES	3,954,762	158,190.48	0.0400
RBC CAPITAL MARKETS	6,500	293.00	0.0451
RBC DAIN RAUSCHER INC	15,800	632.00	0.0400
ROBBINS & HENDERSON	9,600	240.00	0.0250
ROBERT BRANDT	1,500	45.00	0.0300
ROSS SINCLAIRE & ASSOCIATES INC	976,989	39,079.56	0.0400
SANDLER O'NEILL	166,600	6,664.00	0.0400
SANFORD C BERNSTEIN	74,200	1,222.50	0.0165
SOLEIL SECURITIES CO	7,600	304.00	0.0400
STATE STREET BROKERAGE	115,000	3,450.00	0.0300
STEPHENS INC	300	12.00	0.0400
STIFEL NICOLAUS & CO INC	525,996	21,039.84	0.0400
SUNTRUST ROBINSON	13,200	660.00	0.0500
SUSQUEHANNA BROKERAGE	83,100	2,097.00	0.0252
THINK EQUITY PARTNERS	23,100	924.00	0.0400
THOMAS WEISEL PARTNERS	278,920	11,493.80	0.0412
U S BANCORP PIPER JAFFRAY	92,900	4,864.40	0.0524
UBS PAINE WEBBER INC	5,231,187	211,354.98	0.0404
WACHOVIA SECURITIES	2,209,030	110,715.20	0.0501
WEDBUSH MORGAN SEC	8,600	344.00	0.0400
WEEDEN & CO	3,227,900	114,562.00	0.0355
<b>TOTAL</b>	<b>136,644,650</b>	<b>3,834,687.00</b>	<b>0.0281</b>

The over-the-counter commission rate on medium to large capitalization stocks is assumed to be \$.04 per share. The acquisition of initial public offerings (IPOs) represented a portion of small capitalization stock purchases. IPOs usually have a high commission rate. However, the security issuers and not the investors pay the commissions. In 2005-06, the System bought small capitalization IPOs that generated \$113,025.16 in commissions. Although these commissions were not paid by the Retirement System, they resulted from the System's investment activities and are included in the total commissions of \$3,834,687.00. Typical stock transactions occur at lower commission rates than IPO transactions, frequently \$.04 per share or less. Investment companies usually provide investment research for brokerage clients. On occasion, investment companies direct third party research to active clients. The Retirement System received third party research through Lynch Jones Ryan, Merrill Lynch and Lehman Brothers. Trading commissions of \$120,487.85 were associated with third party research obligations. The primary research providers were: Bloomberg, Interactive Data, CRA/Rogers Casey, CMS Bondedge, ISS, QED Information Systems, and Vestek.

**Ten Largest Stock Holdings Ranked\*  
by Market Value  
06/30/06**

<u>Rank</u>	<u>Name</u>	<u>Shares</u>	<u>Market Value</u>
1	Microsoft	8,614,999	200,729,476.70
2	Citigroup Inc	4,006,612	193,278,962.88
3	General Electric Co	5,449,310	179,609,257.60
4	Exxon Mobil Corp	2,293,500	140,706,225.00
5	Bank of America Corp	2,826,700	135,964,270.00
6	Wells Fargo & Co.	1,836,175	123,170,619.00
7	Johnson & Johnson	2,041,859	122,348,191.28
8	Pfizer Inc	4,463,349	104,754,801.03
9	Chevron Corp	1,653,267	102,601,750.02
10	ConocoPhillips	1,466,842	96,122,156.26

**Top Ten Fixed Income Holdings\*  
06/30/06**

<u>Rank</u>	<u>Description</u>	<u>Maturity</u>	<u>Coupon</u>	<u>Par</u>	<u>Market Value</u>
1	US Treasury Bonds	8/15/2023	6.250	114,500,000.00	126,281,019.50
2	US Treasury Bonds	2/15/2021	7.875	46,500,000.00	58,510,066.50
3	US Treasury Notes	5/15/2015	4.125	59,500,000.00	55,249,022.50
4	US Treasury Bonds	8/15/2029	6.125	47,325,000.00	52,619,484.38
5	US Treasury Bonds	5/15/2016	7.250	35,500,000.00	41,105,130.50
6	US Treasury Bonds	8/15/2021	8.125	29,815,000.00	38,435,738.92
7	US Treasury Notes	2/15/2008	3.000	35,000,000.00	33,817,385.00
8	US Treasury Bonds	11/15/2026	6.500	29,000,000.00	33,268,452.00
9	Bank of America Sub Notes	1/15/2011	7.400	30,000,000.00	31,920,510.00
10	US Treasury Notes	5/15/2007	4.375	32,000,000.00	31,755,008.00

\* Detailed information concerning these values along with book values and cost values of all KTRS investments is available upon request.



**Schedule of Investments  
as of June 30, 2006**

Investment	Par Value* or Remaining Principal Balance	Market Value	Percentage of Market Value
Repurchase Agreements	794,300,000.00	794,300,000.00	5.71
Total Short Term	794,300,000.00	794,300,000.00	5.71
Treasury Notes and Bonds	970,750,000.00	1,032,439,778.74	7.43
Agencies	1,055,464,545.25	1,039,092,693.14	7.48
GNMA (Single Family)	18,549,099.92	18,781,577.80	0.14
Collateralized Mortgage Obligations	138,811,507.63	134,884,155.61	0.97
Treasury Strip Bonds	37,000,000.00	33,469,087.00	0.24
Total U.S. Government Obligations	2,220,575,152.80	2,258,667,292.29	16.25
Industrials	541,310,000.00	542,410,465.00	3.90
Finance	1,056,458,513.23	1,023,985,966.07	7.37
Utility Bonds (Except Telephone)	120,191,660.00	119,160,317.26	0.86
Telephone Bonds	45,393,600.00	46,512,517.69	0.33
Total Corporate Bonds	1,763,353,773.23	1,732,069,266.02	12.46
FHA & VA Single Family Mortgages	1,840.02	1,903.59	0.00
Project Mortgages (FHA & GNMA)	12,848,706.95	13,687,213.56	0.10
State and Local Government Issues	181,945,000.00	180,776,223.05	1.30
Total Other Fixed Income	194,795,546.97	194,465,340.20	1.40
Subtotal (Fixed Income)	4,973,024,473.00	4,979,501,898.51	35.83
Real Estate Equity	382,353,090.33	387,193,796.00	2.78
Total Real Estate Equity	382,353,090.33	387,193,796.00	2.78
Common Stocks 103,704,198.00 Shares	3,899,332,683.44	4,219,558,752.73	30.36
Small Cap Stocks 7,691,148.00 Shares	152,625,600.54	172,213,413.46	1.24
Stock Index 89,971,582.00 Shares	3,095,524,345.32	3,410,494,171.14	24.54
600 Stock Index 8,532,072.00 Shares	200,089,712.48	245,502,370.18	1.77
400 Stock Index 3,531,176.00 Shares	114,152,330.20	116,844,696.06	0.84
Todd Alpha 1,496,413.00 Shares	49,756,260.17	47,681,449.70	0.34
International 10,610,521.00 Shares	294,611,874.11	319,698,802.78	2.30
Total Stocks 225,537,110.00 Shares	7,806,092,806.26	8,531,993,656.05	61.39
Subtotal (Equity)	8,188,445,896.59	8,919,187,452.05	64.17
<b>Total Investments</b>	<b>13,161,470,369.59</b>	<b>13,898,689,350.56</b>	<b>100.00</b>

\* In this asset display, par value represents the redemption value of bonds and the cost value of equities. Market value is a volatile measure that changes daily and represents the approximate transaction value of an investment on a particular day--in this case June 30, 2006. Detailed information concerning these values along with book values and cost values of all KTRS investments is available on request.

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# ACTUARIAL SECTION

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for Fiscal Year ending June 30, 2006



**Cavanaugh Macdonald**  
CONSULTING, LLC

December 5, 2006

Board of Trustees  
Teachers' Retirement System of the State of Kentucky  
479 Versailles Road  
Frankfort, KY 40601-3800

Members of the Board:

Section 161.400 of the law governing the operation of the Teachers' Retirement System of the State of Kentucky provides that the actuary shall make an actuarial valuation of the System. We have submitted the results of the annual actuarial valuation prepared as of June 30, 2006. While not verifying the data at source, the actuary performed tests for consistency and reasonability. The valuation indicates that combined member and state contributions for the fiscal year ending June 30, 2009 at the rate of 24.46% of university members' salaries and 27.42% of non-university members' salaries are required to support the benefits of the System. This represents an increase since the previous valuation in the required employer contribution rate of 0.64% of payroll. There has been a net increase in the state special appropriation from 4.17% to 4.25%, or 0.08% of payroll. Therefore, for the 2008/2009 fiscal year, in addition to the state statutory contribution rates and the state special appropriation, there is a required increase in the employer contribution rate of 1.88%; 0.56% from this valuation and 1.32% from the previous valuation. The contribution to the Life Insurance Fund and the Medical Insurance Fund would remain constant at 0.17% and 1.50% respectively.

The valuation takes into account the effect of amendments to the System enacted through the 2006 Session of the Legislature.

The financing objective of the System is that contribution rates will remain relatively level over time as a percentage of payroll. The promised benefits of the System are included in the actuarially calculated contribution rates which are developed using the unit credit actuarial cost method with projected benefits. Five-year market related value of plan assets is used for actuarial valuation purposes. Gains and losses are reflected in the unfunded accrued liability that is being amortized by regular annual contributions as a level percentage of payroll within a 30-year period, on the assumption that payroll will increase by 4.0% annually. The assumptions recommended by the actuary and adopted by the Board are in the aggregate reasonably related to the experience under the System and to reasonable expectations of anticipated experience under the System and meet the parameters for the disclosures under GASB 25 and 27.

We have prepared the trend information shown in the Schedule of Funding Progress in the Financial Section of the Annual Report and Schedule A, Schedule B, Schedule C, Solvency Test and Analysis of Financial Experience shown in the Actuarial Section of the Annual Report.

This is to certify that the independent consulting actuary is a member of the American Academy of Actuaries and has experience in performing valuations for public retirement systems, that the valuation was prepared in accordance with principles of practice prescribed by the Actuarial Standards Board, and that the actuarial calculations were performed by qualified actuaries in accordance with accepted actuarial procedures, based on the current provisions of the retirement system and on actuarial assumptions that are internally consistent and reasonably based on the actual experience of the System.

In our opinion the System is operating on an actuarially sound basis. Assuming that contributions to the System are made by the employer from year to year in the future at the rates recommended on the basis of the successive actuarial valuations, the continued sufficiency of the retirement fund to provide the benefits called for under the System may be safely anticipated.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'E. Macdonald'.

Edward A. Macdonald, ASA, FCA, MAAA  
President

**665 Molly Lane, Suite 150, Woodstock, GA 30189**

**Report of Actuary on the Valuation**  
 Prepared as of June 30, 2006  
**Section I - Summary of Principal Results**

1. For convenience of reference, the principal results of the valuation and a comparison with the results of the previous valuation are summarized below (all dollar amounts are \$1,000's):

Valuation Date	June 30, 2006		June 30, 2005	
Number of active members	73,740		72,281	
Annual salaries	\$ 2,859,477		\$ 2,703,430	
Number of annuitants and beneficiaries	38,497		37,402	
Annual allowances	\$ 1,074,159		\$ 994,745	
Assets				
Market value	\$ 13,783,830		\$ 13,456,026	
Actuarial value	\$ 14,857,641		\$ 14,598,843	
Unfunded actuarial accrued liability	\$ 5,467,140		\$ 4,536,027	
Amortization period (years)	30		30	
	<b>University</b>	<b>Non-University</b>	<b>University</b>	<b>Non-University</b>
Pension Plan:				
Normal	13.91 %	17.22 %	14.39 %	17.84 %
Accrued liability	<u>10.55</u>	<u>10.20</u>	<u>9.43</u>	<u>8.94</u>
Total	<u>24.46</u> %	<u>27.42</u> %	<u>23.82</u> %	<u>26.78</u> %
Member	7.625 %	9.105 %	7.625 %	9.105 %
State (ARC)	<u>16.835</u>	<u>18.315</u>	<u>16.195</u>	<u>17.675</u>
Total	<u>24.46</u> %	<u>27.42</u> %	<u>23.82</u> %	<u>26.78</u> %
Life Insurance Fund:				
State	0.17 %	0.17 %	0.17 %	0.17 %
Medical Insurance Fund:				
Member	0.75 %	0.75 %	0.75 %	0.75 %
State Match	0.75	0.75	0.75	0.75
State Additional	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
Total	1.50 %	1.50 %	1.50 %	1.50 %
Total Contributions:	<u>26.13</u> %	<u>29.09</u> %	<u>25.49</u> %	<u>28.45</u> %
Contribution rates for fiscal year ending:	<b>June 30, 2009</b>		<b>June 30, 2008</b>	
Member Statutory	8.375 %	9.855 %	8.375 %	9.855 %
State Statutory	11.625	13.105	11.625	13.105
Required Increase	1.88	1.88	1.32	1.32
State Special	<u>4.25</u>	<u>4.25</u>	<u>4.17</u>	<u>4.17</u>
Total	26.13 %	29.09 %	25.49 %	28.45 %



2. The valuation indicates that combined member and State contributions at the rate of 24.46% of salaries for university members and at 27.42% for non-university members are sufficient to support the current benefits of the System. We also recommend that 0.17% be contributed by the state to the Life Insurance Fund and 1.50% combined member and state contributions be made to the Medical Insurance Fund. Comments on the valuation results as of June 30, 2006 are given in Section IV and further discussion of the contribution levels is set out in Sections V and VI.
3. Schedule D of this report outlines the full set of actuarial assumptions and methods employed in the current valuation. Since the previous valuation, the assumed rates of withdrawal, disability, retirement and mortality have been revised to reflect the results of the experience investigation for the five year period ending June 30, 2005. These revised assumptions were adopted by the Board of Trustees on September 18, 2006.
4. The valuation takes into account the effect of amendments to the System enacted through the 2006 Session of the Legislature. Since the previous valuation, the System has been amended to grant a one-time 0.8% cost-of-living increase effective July 1, 2006, and a one-time 0.6% cost-of-living increase effective July 1, 2007.
5. All amounts shown prior to the 2004/2005 fiscal year were developed and/or reported by the prior actuarial firm.

**Section II - MEMBERSHIP DATA**

1. Data regarding the membership of the System for use as a basis of the valuation were furnished by the Retirement System office. The following table shows the number of active members and their annual salaries as of June 30, 2006 on the basis of which the valuation was prepared.

<b>Group</b>	<b>Number</b>	<b>Annual Salaries (\$1,000)</b>
Males	17,938	\$ 776,490
Females	<u>55,802</u>	<u>2,082,987</u>
Total	73,740	\$ 2,859,477

*The table reflects the active membership for whom complete valuation data was submitted. The results of the valuation were adjusted to take account of inactive members and members for whom incomplete data was submitted.*



2. The following table shows the number and annual retirement allowances payable to annuitants and beneficiaries on the roll of the Retirement System as of the valuation date.

<b>The Number and Annual Retirement Allowances of Annuitants and Beneficiaries on the Roll as of June 30, 2006</b>		
Group	Number	Annual Retirement Allowances <sup>1</sup> (\$1,000)
Service Retirements	33,684	\$ 984,911
Disability Retirements	2,038	48,026
Beneficiaries of Deceased Members	<u>2,775</u>	<u>41,222</u>
Total	38,497	\$ 1,074,159

<sup>1</sup> Includes cost-of-living adjustments effective through July 1, 2007.

3. Table 1 of Schedule F shows a distribution by age and years of service of the number and annual salaries of active members included in the valuation, while Table 2 shows the number and annual retirement allowances of annuitants and beneficiaries included in the valuation, distributed by age.

### Section III - ASSETS

1. As of June 30, 2006 the market value of Pension Plan assets for valuation purposes held by the System amounted to \$13,783,830,173. This value excludes assets in the Medical Insurance Fund, the 403(b) Program Reserve Fund, and the Life Insurance Fund, which are not included in the assets used for Pension Plan valuation purposes.
2. The five-year market related value of Pension Plan assets used for valuation purposes as of June 30, 2006 was \$14,857,641,238. Schedule B shows the development of the actuarial value of assets as of June 30, 2006.
3. Schedule C shows the receipts and disbursements for the year preceding the valuation date and a reconciliation of the asset balances for the Pension Plan and the Life Insurance Fund.



#### Section IV - COMMENTS ON VALUATION

1. Schedule A of this report outlines the results of the actuarial valuation (amounts are \$1,000's). The valuation was prepared in accordance with the actuarial assumptions and the actuarial cost method, which are described in Schedule D.
2. The valuation shows that the System has an actuarial accrued liability of \$8,108,193 for benefits expected to be paid on account of the present active membership, based on service to the valuation date. The liability on account of benefits payable to annuitants and beneficiaries amounts to \$12,033,112 of which \$1,059,382 is for special appropriations remaining to be made toward funding minimum annuities, ad hoc increases and sick leave allowances granted after 1981. The liability for benefits expected to be paid to inactive members and to members entitled to deferred vested benefits is \$183,475. The total actuarial accrued liability of the System amounts to \$20,324,781. Against these liabilities, the System has present assets for valuation purposes of \$14,857,641. When this amount is deducted from the actuarial accrued liability of \$20,324,781, there remains \$5,467,140 as the unfunded actuarial accrued liability.
3. The normal contribution rate is equal to the actuarial present value of benefits accruing during the current year divided by the annual active members' payroll. The normal contribution rate is determined to be 13.91% of payroll for university members and 17.22% for non-university members.

#### Section V - CONTRIBUTIONS PAYABLE UNDER THE SYSTEM

1. Section 161.540 of the retirement law provides that each university member will contribute 8.375% of annual salary to the System and each non-university member will contribute 9.855% of annual salary. Of this amount, 0.75% is paid to the Medical Insurance Fund for medical benefits leaving 7.625% for university members and 9.105% for non-university members applicable for the retirement benefits taken into account in the valuation.
2. Section 161.550 provides that the State will match the member contributions and contribute a supplemental 3.25% of members' salaries towards discharging the System's unfunded obligations. The System was amended as of June 30, 2000 to allow the Board to allocate up to a maximum of the entire 3.25% to the Medical Insurance Fund. For the 2008/2009 fiscal year, we recommend that the Board allocate the entire 3.25% towards the Pension Plan.
3. Therefore, 10.875% of active university members' salaries and 12.355% of active non-university members' salaries is funded by statute or supplemental funding for the Pension Plan and Life Insurance Fund. Of this amount, 0.17% of payroll will be allocated to the Life Insurance Fund. Based on the results of the valuation, an additional 1.88% of payroll for both university and non-university will be required in order to maintain the amortization of the unfunded liability of the Pension Plan within a 30-year period. An additional special appropriation of 4.25% of total payroll will be made by the State. The total required employer contribution rate to the Pension Plan is, therefore, 16.835% for university members and 18.315% for non-university members. The total member and employer contribution rates to the Pension Plan are shown in the following table.



<b>Contribution Rates by Source</b>		
<u>Member</u>	UNIVERSITY	NON-UNIVERSITY
Statutory Total	8.375 %	9.855 %
Statutory Medical Insurance Fund	<u>(0.75)</u>	<u>(0.75)</u>
Contribution to Pension Plan	7.625 %	9.105 %
 <u>Employer</u>		
Statutory Matching Total	8.375 %	9.855 %
Statutory Medical Insurance Fund	(0.75)	(0.75)
Supplemental Funding	<u>3.25</u>	<u>3.25</u>
Subtotal	10.875 %	12.355 %
Life Insurance	(0.17) %	(0.17) %
Additional to Maintain 30-Year Amortization	1.88	1.88
Special Appropriation	<u>4.25</u>	<u>4.25</u>
Contribution to Pension Plan	16.835 %	18.315 %
Total Contribution to Pension Plan	24.46 %	27.42 %

4. The valuation indicates that normal contributions at the rate of 13.91% of active university members' salaries are required to meet the cost of benefits currently accruing. The normal rate for non-university members is 17.22%. The difference between the total contribution rate and the normal rate remains to be applied toward the liquidation of the unfunded actuarial accrued liability. This accrued liability rate is 10.55% for university members and 10.20% for non-university members. These rates include special appropriations of 4.25% of payroll to be made by the State. These rates are shown in the following table.

<b>ACTUARIALLY DETERMINED CONTRIBUTION RATES</b>		
Rate	<b>PERCENTAGE OF ACTIVE MEMBERS' SALARIES</b>	
	<b>University</b>	<b>Non-University</b>
Normal	13.91 %	17.22 %
Accrued Liability*	<u>10.55</u>	<u>10.20</u>
Total	24.46 %	27.42 %

\* Includes special appropriations of 4.25% of payroll to be made by the State.

5. The unfunded actuarial accrued liability amounts to \$5,467,1400,00 as of the valuation date. Accrued liability contributions at the rate of 10.55% of active university members' payroll and 10.20% of non-university members' payroll are sufficient to amortize the unfunded actuarial accrued liability over a 30-year period, based on the assumption that the payroll will increase by 4.0% annually.





**Section VI - COMMENTS ON LEVEL OF FUNDING**

1. The benefit percentage for non-university members is 2.0% for service accrued through July 1, 1983 and 2.5% for service up to 30 years accrued after that date. However, for members who join the System on or after July 1, 2002 and retire with less than 10 years of service, the benefit percentage is 2.0%. For members who joined the System on or after July 1, 2002, who retire with 10 or more years of service, the benefit percentage is 2.5% for all years of service up to 30 years. For all members who retire on or after July 1, 2004, the benefit percentage for service earned in excess of 30 years is 3.0%. The total net contribution rate is 27.42% of payroll for non-university members. For university members the benefit percentage is 2.0% for all service and the contribution rate is 24.46%. Our calculations indicate that these contribution rates will be sufficient to cover the benefits of the System, the annual 1.5% increases in the allowances of retired members and beneficiaries, and the liabilities for minimum annuities, ad hoc increases and sick leave allowances granted after 1981.
2. The valuation indicates that the present statutory contribution rates, supplemental funding and special appropriations, if continued at the current level percentage, along with an additional required contribution of 1.88%, not currently provided in statute, are sufficient to meet the cost of benefits currently accruing and provide for the amortization of the unfunded actuarial accrued liability over a period of 30 years. However, as existing special contributions expire, the statutory contributions or supplemental funding will be required to increase as an equal percentage of payroll, in order to amortize the unfunded liability within a period of 30 years.
3. The System has been operating on an actuarially sound basis. However, there are no excess assets or contributions available to provide additional benefits, and there is a cumulative increase in the required employer contribution of 1.88% of payroll for the fiscal year ending June 30, 2009, as shown in the following table:

<u>Valuation Date</u>	<u>Fiscal Year</u>	<u>Increase</u>	<u>Cumulative Increase</u>
June 30, 2004	June 30, 2007	0.11%	0.11%
June 30, 2005	June 30, 2008	1.21	1.32
June 30, 2006	June, 30, 2009	0.56	1.88

In addition, as existing special contributions expire, the statutory contributions or supplemental funding will be required to increase as an equal percentage of payroll, in order to amortize the unfunded liability within 30 years. Any further benefit improvements must be accompanied by the entire additional contributions necessary to support the benefits.



ACTUARIAL SECTION

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**Section VII - ANALYSIS OF FINANCIAL EXPERIENCE**

The following table shows the estimated gain or loss from various factors that resulted in an increase of \$931,113,000 in the unfunded accrued liability from \$4,536,027,000 to \$5,467,140,000 during the year ending June 30, 2006.

<i>(Dollar amounts in thousands)</i>	ITEM	Amount of Increase/ (Decrease)
	Interest (7.50%) added to previous unfunded accrued liability	\$ 340,202
	Accrued liability contribution	(168,343)
	<b>Experience:</b>	
	Valuation asset growth	448,987
	Pensioners' mortality	(5,966)
	Turnover and retirements	(17,637)
	New entrants	66,856
	Salary increases	104,671
	Amendments	161,952
	Assumption and method changes	<u>391</u>
	<b>TOTAL</b>	<b>\$ 931,113</b>

**Section VIII - ACCOUNTING INFORMATION**

1. Governmental Accounting Standards Board Statements 25 and 27 set forth certain items of required supplementary information to be disclosed in the financial statements of the System and the employer. One such item is a distribution of the number of employees by type of membership, as follows:

Number of Active and Retired Members as of June 30, 2006	
GROUP	NUMBER
Retirees and Beneficiaries currently receiving benefits	38,497
Terminated employees entitled to benefits but not yet receiving benefits	4,275
Active Plan Members	<u>73,740</u>
<b>TOTAL</b>	<b>116,512</b>

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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2. Another such item is the schedule of funding progress as shown below.

Schedule of Funding Progress (Dollar amount in thousands)						
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	(UAAL as a Percentage of Covered Payroll ( (b-a) /c)
06/30/01*	\$ 13,299,161	\$ 14,642,129	\$ 1,342,968	90.8 %	\$ 2,213,772	60.7%
06/30/02	13,588,847	15,695,574	2,106,726	86.6	2,313,663	91.1
06/30/03	13,863,786	16,594,781	2,730,995	83.5	2,497,731	109.3
06/30/04	14,255,131	17,617,626	3,362,495	80.9	2,641,533	127.3
06/30/05	14,598,843	19,134,870	4,536,027	76.3	2,703,430	167.8
06/30/06*	14,857,641	20,324,781	5,467,140	73.1	2,859,477	191.2

\* Reflects change in decremental assumptions.  
All figures prior to 06/30/2005 were reported by prior actuarial firm.

3. The information presented in the required supplementary schedules was determined as part of the actuarial valuation at June 30, 2006. Additional information as of the latest actuarial valuation follows.

Valuation Date .....	06/30/2006	<b>Actuarial Assumptions:</b>
Actuarial cost method .....	Projected unit credit	<u>Investment Rate of Return*</u>
Amortization method .....	Level percent of pay, open	7.50%
Remaining amortization period .....	30 years	<u>Projected Salary Increases*</u>
Asset valuation method .....	5-year smoothed market	4.00 - 8.20%
		<u>Cost-of-Living Adjustment</u>
		1.50% Annually
		*Includes Inflation at 4.00%

**TREND INFORMATION**

<u>Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation (NPO)</u>
June 30, 2004	\$ 364,351,412	100%	\$ 0
June 30, 2005	383,776,826	100%	0
June 30, 2006	406,107,266	100%	0

The required employer contribution increase of 0.11% is scheduled for the current 2007 fiscal year budget and the increase of 1.32% is scheduled for the 2008 fiscal year budget. However, a portion of the pension contribution stream was contributed to the Medical Stabilization Fund. Therefore, there will be an NPO for the fiscal year ending June 30, 2007.



ACTUARIAL SECTION

**SCHEDULE A**  
**Results of the Valuation**  
**Prepared as of June 30, 2006**  
**(\$1,000's)**

**1. ACTUARIAL ACCRUED LIABILITY**

Present value of prospective benefits payable in respect of:

(a) Present active members:		
• Service retirement benefits	\$ 7,580,014	
• Disability retirement benefits	331,190	
• Death and survivor benefits	63,063	
• Refunds of member contributions	<u>133,926</u>	
Total		\$ 8,108,193
(b) Present inactive members and members entitled to deferred vested benefits:		183,475
(c) Present annuitants and beneficiaries:		
• Service retirement benefits	\$ 11,265,660	
• Disability retirement benefits	381,567	
• Death and survivor benefits	<u>385,886</u>	
Total		<u>12,033,112</u>
(d) Total actuarial accrued liability		\$ 20,324,781

**2. PRESENT ASSETS FOR VALUATION PURPOSES**

14,857,641

**3. Unfunded Actuarial Accrued Liability**  
 [(1) MINUS (2)]

\$ 5,467,140

**4. NORMAL CONTRIBUTION RATE**

UNIVERSITY

NON-UNIVERSITY

(a) Actuarial present value of benefits accruing annually	\$ 24,509	\$ 462,089
(b) Annual payroll of active members	\$ 176,135	\$ 2,683,342
(c) Normal contribution rate [4(a) divided by 4(b)]	13.91%	17.22%

**Solvency Test**

*(in millions of dollars)*

		(1)	(2)	(3)	
Fiscal Year		Active Member Contributions	Retirants and Beneficiaries	Active Members (Employer Financed Portion)	Valuation Assets
	2001	\$ 2,215.5	\$ 8,037.0	\$ 4,389.6	\$ 13,299.2
	2002	2,302.3	8,816.9	4,576.4	13,588.8
	2003	2,413.9	9,329.3	4,851.6	13,863.8
	2004	2,546.1	9,906.2	5,165.3	14,255.1
	2005	2,621.3	11,370.4	5,143.2	14,598.8
	2006	2,615.8	12,216.6	5,492.4	14,857.6
Fiscal Year		(1)	(2)	(3)	
<b>Portion of Accrued Liabilities Covered by Assets</b>	2001	100 %	100 %	69 %	
	2002	100	100	54	
	2003	100	100	44	
	2004	100	100	35	
	2005	100	100	12	
	2006	100	100	0	



KENTUCKY TEACHERS' RETIREMENT SYSTEM

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**SCHEDULE B**  
**Development of Actuarial Value of Assets**  
**as of June 30, 2006**

(1)	Actuarial Value Beginning of Year	\$ 14,598,842,537
(2)	Market Value End of Year	\$ 13,783,830,173
(3)	Market Value Beginning of Year	\$ 13,456,025,741
(4)	Cash Flow	
	a. Contributions	\$ 664,572,122
	b. Benefit Payments	<u>1,037,706,643</u>
	c. Net	\$ (373,134,521)
(5)	Investment Income	
	a. Market total: (2) - (3) - (4)c	\$ 700,938,953
	b. Assumed Rate	7.50%
	c. Amount for Immediate Recognition [(1) x (5)b] + [(4)c * (5)b * 0.5]	\$ 1,080,920,646
	d. Amount for Phased-In Recognition (5)a - (5)c	\$ (379,981,693)
(6)	Phased-In Recognition of Investment Income	
	a. Current Year: 0.20*(5)d	\$ (75,996,339)
	b. First Prior Year	(23,843,540)
	c. Second Prior Year	(349,147,545)
	d. Third Prior Year	0
	e. Fourth Prior Year	<u>0</u>
	f. Total Recognized Investment Gain	\$ (448,987,424)
(7)	Actuarial Value End of Year: (1) + (4)c + (5)c + (6)f	\$ 14,857,641,238
(8)	Difference Between Market & Actuarial Values (2) - (7)	\$ (1,073,811,065)

**SCHEDULE C**  
**PENSION PLAN ASSETS**  
**Summary of Receipts & Disbursements\***  
**(Market Value)**

	For the Year Ending	
	June 30, 2006	June 30, 2005
<b>RECEIPTS FOR THE YEAR</b>		
Contributions		
Members	\$ 258,464,856	\$ 247,024,518
Employers	<u>406,107,266</u>	<u>383,776,826</u>
Total	\$ 664,572,122	\$ 630,801,344
Net Investment Income	<u>707,778,812</u>	<u>943,831,270</u>
<b>TOTAL</b>	<b>\$ 1,372,350,934</b>	<b>\$ 1,574,632,614</b>
<b>DISBURSEMENTS FOR THE YEAR</b>		
Benefits Payments	\$ 1,024,872,421	\$ 959,518,739
Refunds to Members	12,834,222	10,975,941
Medical Insurance Premium	0	0
Miscellaneous, including expenses	<u>6,839,859</u>	<u>6,652,672</u>
<b>TOTAL</b>	<b>\$ 1,044,546,502</b>	<b>\$ 977,147,352</b>
<b>EXCESS OF RECEIPTS OVER DISBURSEMENTS</b>	<b>\$ 327,804,432</b>	<b>\$ 597,485,262</b>
<b>RECONCILIATION OF ASSET BALANCES</b>		
Asset Balance as of the Beginning of the Year	\$ 13,456,025,741	\$ 12,858,540,479
Excess of Receipts over Disbursements	<u>327,804,432</u>	<u>597,485,262</u>
Asset Balance as of End of the Year	<u>\$ 13,783,830,173</u>	<u>\$ 13,456,025,741</u>

\* Excludes assets for Medical Insurance Fund, the 403(b) Program Reserve Fund and the Life Insurance Fund.



ACTUARIAL SECTION

**SCHEDULE C**  
**MEDICAL INSURANCE FUND**  
**Summary of Receipts & Disbursements**  
**(Market Value)**

	For the Year Ending	
<u>RECEIPTS FOR THE YEAR</u>	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Contributions		
Members	\$ 51,697,167	\$ 51,576,031
Employers	<u>89,319,498</u>	<u>79,022,562</u>
Total	\$ 141,016,665	\$ 130,598,593
Recovery Income	118,419	0
Medicare D Receipts	5,999,560	0
Net Investment Income	<u>6,804,286</u>	<u>6,507,538</u>
TOTAL	\$ 153,938,930	\$ 137,106,131
<u>DISBURSEMENTS FOR THE YEAR</u>		
Benefits Payments	\$ 0	\$ 0
Refunds to Members	5,143	9,072
Medical Insurance Premium	165,006,322	142,349,436
Miscellaneous, including expenses	<u>4,624,074</u>	<u>4,070,892</u>
TOTAL	\$ 169,635,539	\$ 146,429,400
<u>EXCESS OF RECEIPTS OVER DISBURSEMENTS</u>	\$ (15,696,609)	\$ (9,323,269)
<u>RECONCILIATION OF ASSET BALANCES</u>		
Asset Balance as of the Beginning of the Year	\$ 147,310,894	\$ 156,634,164
Excess of Receipts over Disbursements	<u>(15,696,609)</u>	<u>(9,323,269)</u>
Asset Balance as of End of the Year	<u>\$ 131,814,285</u>	<u>\$ 147,310,895</u>

**SCHEDULE C**  
**LIFE INSURANCE FUND\***  
**Summary of Receipts & Disbursements**  
**(Market Value)**

	For the Year Ending	
<u>RECEIPTS FOR THE YEAR</u>	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Contributions		
Members	\$ 0	\$ 0
Employers	<u>4,813,703</u>	<u>4,569,612</u>
Total	\$ 4,813,703	\$ 4,569,612
Net Investment Income	<u>2,689,330</u>	<u>2,239,285</u>
TOTAL	\$ 7,503,033	\$ 6,808,897
<u>DISBURSEMENTS FOR THE YEAR</u>		
Benefits Payments	\$ 3,894,000	\$ 3,852,800
Refunds to Members	0	0
Medical Insurance Premium	0	0
Miscellaneous, including expenses	<u>0</u>	<u>0</u>
TOTAL	\$ 3,894,000	\$ 3,852,800
<u>EXCESS OF RECEIPTS OVER DISBURSEMENTS</u>	\$ 3,609,033	\$ 2,956,097
<u>RECONCILIATION OF ASSET BALANCES</u>		
Asset Balance as of the Beginning of the Year	\$ 63,972,204	\$ 61,016,107
Excess of Receipts over Disbursements	<u>3,609,033</u>	<u>2,956,097</u>
Asset Balance as of End of the Year	<u>\$ 67,581,237</u>	<u>\$ 63,972,204</u>

\* The retiree portion of the Life Insurance Fund when allocated will be moved to the GASB 43 and 45 report next year.



**SCHEDULE D**

**Outline of Actuarial Assumptions and Methods**

**The assumptions and methods used in the valuation were selected by the Actuary based on the actuarial experience investigation as of June 30, 2005 and adopted by the Board of Trustees on September 18, 2006.**

**INVESTMENT RATE OF RETURN:** 75% per annum, compounded annually.

**SALARY INCREASES:** Representative values of the assumed annual rates of future salary increases are as follows and include inflation at 4.0% per annum:

Age	20	25	30	35	40	45	50	55	60	65
Annual Rate	8.10%	7.20%	6.20%	5.50%	5.00%	4.70%	4.50%	4.30%	4.20%	4.00%

**Separations From Service:** Representative values of the assumed annual rates of death, disability, withdrawal, service retirement and early retirement are as follows:

MALES: Annual Rate of . . .							
AGE	DEATH	DISABILITY	WITHDRAWAL			RETIREMENT	
			0 - 4	5 - 9	10+	Before 27 Years of Service	After 27 Years of Service*
20	0.003%	0.01%	9.00%				
25	0.010	0.01	9.00	1.50%			
30	0.016	0.02	9.00	3.00	3.00%		
35	0.032	0.05	10.00	3.25	1.50		
40	0.048	0.08	10.00	3.75	1.50		
45	0.064	0.22	9.50	2.50	1.50		25.0%
50	0.104	0.42	10.00	4.00	3.00		20.0
55	0.216	0.60	11.00	3.00	2.70	6.0%	35.0
60	0.375	0.79	11.00	3.00	2.70	14.0	25.0
62	0.438	0.83	11.00	3.00	2.70	14.0	23.0
65	0.566	0.90	11.00	3.00	2.70	22.5	35.0
70	0.905	0.00	0.00	0.00	0.00	100.0	100.0

*\* Plus 5% before age 55 and 15% after age 55 in year when first eligible for unreduced retirement with 27 years of service.*



ACTUARIAL SECTION

FEMALES: Annual Rate of . . .							
AGE	DEATH	DISABILITY	WITHDRAWAL			RETIREMENT	
			0 - 4	5 - 9	10+	Before 27 Years of Service	After 27 Years of Service*
20	0.002 %	0.03%	6.00%				
25	0.007	0.03	8.50	3.00%			
30	0.014	0.04	9.00	4.00	1.50%		
35	0.026	0.11	8.50	4.00	2.00		
40	0.044	0.22	8.50	2.50	1.50		
45	0.055	0.38	7.00	2.50	1.50		25.0%
50	0.066	0.44	8.50	3.00	2.25		20.0
55	0.085	0.56	10.00	3.50	2.50	7.5%	35.0
60	0.122	0.85	11.00	3.50	2.50	16.5	30.0
62	0.137	0.85	11.00	3.50	2.50	12.5	25.0
65	0.159	0.85	11.00	3.50	2.50	26.0	30.0
70	0.195	0.00	0.00	0.00	0.00	100.0	100.0

\* Plus 5% before age 55 and 20% after age 55 in year when first eligible for unreduced retirement with 27 years of service.

**Deaths After Retirement:** According to the 1994 Group Annuity Mortality Table for the period after service retirement. Special rates are used for the period after disability retirement. Representative values of the assumed annual rates of death after service and disability retirement are as follows:

**Annual Rate of Death After . . .**

Age	Service Retirement		Disability Retirement	
	MALE	FEMALE	MALE	FEMALE
45	0.1578 %	0.0973 %	6.500 %	6.500 %
50	0.2579	0.1428	10.000	10.000
55	0.4425	0.2294	10.000	10.000
60	0.7976	0.4439	9.000	9.000
65	1.4535	0.8636	10.000	10.000
70	2.3730	1.3730	6.500	4.500
75	3.7211	2.2686	7.000	6.000
80	6.2027	3.9396	10.000	6.500
85	9.7240	6.7738	12.500	7.500
90	15.2931	11.6265	15.000	17.500
95	23.3606	18.6213	23.368	31.702

**Actuarial Method:** Unit Credit Actuarial Cost Method with projected benefits. Actuarial gains and losses are reflected in the unfunded actuarial accrued liability.

**Assets:** Five-year market related actuarial value, as developed in Schedule B. The actuarial value of assets recognizes a portion of the difference between the market value of assets and the expected actuarial value of assets, based on the assumed valuation rate of return of 7.50%. The amount recognized each year is 20% of the difference between market value and expected actuarial value.

**Expense Load:** None.

**Percent Married:** 100%, with females 3 years younger than males.

**Loads:** Unused Sick Leave: 1% of active liability





## **SCHEDULE E**

### **Summary of Main System Provisions As Interpreted for Valuation Purposes**

The Teachers' Retirement System of the State of Kentucky was established on July 1, 1940. The valuation took into account amendments to the System effective through June 30, 2006. The following summary describes the main benefit and contribution provisions of the System as interpreted for the valuation.

#### **1. DEFINITIONS**

"Final average salary" means the average of the five highest annual salaries which the member has received for service in a covered position and on which the member has made contributions or on which the public board, institution or agency has picked up the member contributions. For a member who retires after attaining age 55 with 27 years of service, "final average salary" means the average of the three highest annual salaries.

#### **2. BENEFITS**

##### **Service Retirement Allowance**

**Condition for Allowance:** Completion of 27 years of service or attainment of age 55 and 5 years of service.

**Amount of Allowance:** The annual retirement allowance for non-university members is equal to:

- (a) 2.0% of final average salary multiplied by service before July 1, 1983, plus
- (b) 2.5% of final average salary multiplied by service after July 1, 1983.
- (c) For individuals who become members of the Retirement System on or after July 1, 2002 and have less than 10 years of service at retirement, the retirement allowance is 2.0% of final average salary multiplied by service. If, however, they have 10 or more years, they receive a benefit percentage of 2.5% for all years of service up to 30 years.
- (d) For members retiring on or after July 1, 2004, the retirement allowance formula is 3.0% of final average salary for each year of service credit earned in excess of 30 years.

The annual retirement allowance for university members is equal to 2.0% of final average salary multiplied by all years of service.

For all members, the annual allowance is reduced by actuarial equivalent factors from the earlier of age 60 or the date the member would have completed 27 years of service.

The minimum annual service allowance for all members is \$440 multiplied by credited service.



**Disability Retirement Allowance**

**Condition for Allowance:** Totally and permanently incapable of being employed as a teacher and under age 60 but after completing 5 years of service.

**Amount of Allowance:** The disability allowance is equal to the greater of the service retirement allowance or 60% of the member's final average salary. The disability allowance is payable over an entitlement period equal to 25% of the service credited to the member at the date of disability or five years, whichever is longer. After the disability entitlement period has expired and if the member remains disabled, he will be retired under service retirement. The service retirement allowance will be computed with service credit given for the period of disability retirement. The allowance will not be less than \$6,000 per year. The service retirement allowance will not be reduced for commencement of the allowance before age 60 or the completion of 27 years of service.

**Benefits Payable on Separation from Service**

Any member who ceases to be in service is entitled to receive his contributions with allowable interest. A member who has completed 5 years of creditable service and leaves his contributions with the System may be continued in the membership of the System after separation from service, and file application for service retirement after the attainment of age 60.

**Life Insurance**

A separate Life Insurance fund has been created as of June 30, 2000, to pay benefits on behalf of deceased KTRS active and retired members.

**Death Benefits**

A surviving spouse of an active member with less than 10 years of service may elect to receive an annual allowance of \$2,880 except that if income from other sources exceeds \$6,600 per year the annual allowance will be \$2,160.

A surviving spouse of an active member with 10 or more years of service may elect to receive an allowance which is the actuarial equivalent of the allowance the deceased member would have received upon retirement. The allowance will commence on the date the deceased member would have been eligible for service retirement and will be payable during the life of the spouse.

If the deceased member is survived by unmarried children under age 18 the following schedule of annual allowances applies:

<u>Number of Children</u>	<u>Annual Allowance</u>
1	\$ 2,400
2	4,080
3	4,800
4 or more	5,280

The allowances are payable until a child attains age 18, or age 23 if a full-time student.

If the member has no eligible survivor, a refund of his accumulated contributions is payable to his estate.



**Options:**

In lieu of the regular Option 1, a retirement allowance payable in the form of a life annuity with refundable balance, any member before retirement may elect to receive a reduced allowance which is actuarially equivalent to the full allowance, in one of the following forms:

Option 2. A single life annuity payable during the member's lifetime with payments for 10 years certain.

Option 3. At the death of the member his allowance is continued throughout the life of his beneficiary.

Option 3(a). At the death of the beneficiary designated by the member under Option 3, the member's benefit will revert to what would have been paid had he not selected an option.

Option 4. At the death of the member one half of his allowance is continued throughout the life of his beneficiary.

Option 4(a). At the death of the beneficiary designated by the member under Option 4, the member's benefit will revert to what would have been paid had he not selected an option.

**Post-Retirement Adjustments**

The retirement allowance of each retired member and of each beneficiary shall be increased by 1.50% each July 1.

**3. CONTRIBUTIONS**

**Member Contributions**

University members contribute 8.375% of salary of which 7.625% is contributed to the Retirement System and 0.75% is contributed to the Medical Insurance Fund. Non-university members contribute 9.855% of salary of which 9.105% is contributed to the Retirement System and 0.75% is contributed to the Medical Insurance Fund. Member contributions are picked up by the employer.



ACTUARIAL SECTION

**Schedule of Retirants, Beneficiaries and Survivors  
Added to and Removed from Rolls**

Fiscal Year	Add to Rolls		Remove from Rolls		Rolls End-of-Year	
	Number	Annual Allowances (Millions)	Number	Annual Allowances (Millions)	Number	Annual Allowances (Millions)
2001	2,410	\$ 77.0	1,128	\$ 16.5	31,897	\$ 679.8
2002	2,577	86.2	1,063	16.8	33,408	749.2
2003	2,252	86.7	1,015	16.9	34,645	819.0
2004	2,126	85.4	1,033	17.5	35,738	887.0
2005	2,644	105.1	1,036	18.9	37,346	973.1
2006	2,266	121.1	1,115	20.0	38,497	1,074.2

Fiscal Year	% Increase in Annual Allowances	Average Annual Allowances
2001	9.8	\$ 21,311
2002	10.2	22,425
2003	9.3	23,641
2004	8.3	24,819
2005	9.7	26,058
2006	10.4	27,902

**Schedule of Active Member Valuation Data**

Fiscal Year	(1) Number of Active Members	(2) Total Annual Payroll	(3) Average Annual Pay	(4) % Increase (Decrease) in Average Pay
F 2001	53,570	\$ 2,213,772,000	41,325	2.7%
F 2002	54,175	2,313,663,000	42,707	3.3
F 2003	54,048	2,394,436,000	44,302	3.7
P 2003	17,049	103,295,000	6,059	N/A
F 2004	54,869	2,541,238,000	46,315	4.5
P 2004	17,081	100,295,000	5,872	-3.1
F 2005	55,003	2,597,795,000	47,230	2.0
P 2005	17,278	105,665,000	6,115	4.2
F 2006	56,115	2,745,474,000	48,926	3.6
P 2006	17,625	114,003,000	6,468	5.8

\* Effective July 1, 2002, substitute and part-time teachers joined the field of membership.  
F: Full-time P: Part-time

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# STATISTICAL SECTION

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for Fiscal Year ending June 30, 2006

This section of the Kentucky Teachers' Retirement System Comprehensive Annual Financial Report (KTRS CAFR) presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information regarding the System's overall financial health.

### Contents

Financial Trends ..... page 83

These schedules contain trend information to help the reader understand how KTRS's financial performance & well-being have changed over time.

Demographic & Economic Information ..... page 85

These schedules offer demographic and economic indicators to help the reader understand the System's environment within which KTRS's financial activities take place.

Operating Information ..... page 93

These schedules contain benefits service and employer contribution data to help the reader understand how KTRS's financial report relates to KTRS's services and activities.

STATISTICAL SECTION

**Defined Benefit Plan**

Past Ten Fiscal Years

**Additions by Source**

YEAR	Employer Contributions	Member Contributions	Net Investment Income	Total Additions to Plan Net Assets
2006	\$ 410,920,969	\$ 258,464,856	\$ 717,308,002	\$ 1,386,693,827
2005	388,346,438	247,024,518	946,070,556	1,581,441,512
2004	382,280,099	238,922,086	1,158,182,688	1,779,384,873
2003	341,132,900	233,429,797	538,552,074	1,113,114,771
2002	303,521,106	224,361,453	(520,214,494)	7,668,065
2001	280,108,701	208,702,802	(104,903,741)	383,907,762
2000	311,286,811	203,149,281	454,251,324	968,687,416
1999	288,543,990	194,747,429	1,274,764,370	1,758,055,789
1998	294,323,253	185,010,298	1,832,126,412	2,311,459,963
1997	293,733,987	182,182,151	1,543,100,319	2,019,016,457

**Deductions by Type**  
(Including Benefits by Type)

YEAR	Service Retirants	Disability Retirants	Survivors	Life Insurance	TOTAL Benefits	Refunds	Administrative Expense	Total Deductions to Plan Net Assets
2006	\$ 972,018,057	\$ 46,750,585	\$12,943,639	\$ 3,894,000	\$1,035,606,281	\$ 12,834,222	\$ 6,839,859	\$1,055,280,362
2005	902,863,420	44,070,071	12,585,248	3,852,800	963,371,539	10,975,941	6,652,673	981,000,153
2004	827,731,523	41,491,490	12,047,275	4,015,801	885,286,089	10,471,607	6,578,420	902,336,116
2003	763,099,082	38,744,454	11,259,332	3,961,800	817,064,668	9,951,410	6,388,183	833,404,261
2002	688,754,130	35,947,786	10,532,466	4,210,800	739,445,182	9,146,820	6,677,819	755,269,821
2001	627,637,879	32,233,070	10,005,656	4,110,400	673,987,005	10,673,981	5,950,036	690,611,022
2000	568,538,294	29,148,420	9,322,582	2,350,600	609,359,896	11,304,485	4,859,623	625,524,004
1999	509,787,784	26,464,287	8,718,626	2,329,800	547,300,497	9,083,461	4,522,908	560,906,866
1998	456,373,587	24,305,495	8,375,394	2,293,906	491,348,382	9,389,791	3,997,314	504,735,487
1997	399,402,290	21,775,003	8,204,891	2,123,959	431,506,143	8,032,371	3,487,707	443,026,231

**Changes in Net Assets**

YEAR	Total Additions to Plan Net Assets	Total Deductions to Plan Net Assets	Changes in Plan Net Assets
2006	\$ 1,386,693,827	\$ 1,055,280,362	\$ 331,413,465
2005	1,581,441,512	981,000,153	600,441,359
2004	1,779,384,873	902,336,116	877,048,757
2003	1,113,114,771	833,404,261	279,710,510
2002	7,668,065	755,269,821	(747,601,756)
2001	383,907,762	690,611,022	(306,703,260)
2000	968,687,416	625,524,004	343,163,412
1999	1,758,055,789	560,906,866	1,197,148,923
1998	2,311,459,963	504,735,487	1,806,724,476
1997	2,019,016,457	443,026,231	1,575,990,226

Year Ended June 30, 2006



KENTUCKY TEACHERS' RETIREMENT SYSTEM

**Medical Insurance Plan**

Past Ten Fiscal Years

**Additions by Source**

YEAR	Employer Contributions	Member Contributions	Recovery Income	Net Investment Income	Total Additions to Plan Net Assets
2006	\$ 89,319,498	\$ 51,697,167	\$ 6,117,979	\$ 6,804,286	\$ 153,938,930
2005	79,022,562	51,576,031		6,507,537	137,106,130
2004	53,346,747	53,903,551		7,127,109	114,377,407
2003	77,235,407	50,718,084		7,391,671	135,345,162
2002	95,261,407	46,184,010		6,142,817	147,588,234
2001	92,429,167	40,017,682		5,286,426	137,733,275
2000	48,946,646	36,392,846		3,710,881	89,050,373
1999	46,168,014	34,579,816		2,306,711	83,054,541
1998	35,169,982	33,136,955		1,649,075	69,956,012
1997	34,873,431	29,486,665		1,950,799	66,310,895

**Deductions by Type**  
(Including Benefits by Type)

**Insurance Benefit Expense**

YEAR	Insurance Benefit Expense			Total Insurance Benefits Expense	Refunds	Administrative Expense	Total Deductions to Plan Net Assets
	Under Age 65	Age 65 & Over	All Ages**				
2006	\$ 102,159,471	\$ 62,846,851	\$ 0	\$ 165,006,322	\$ 5,143	\$ 4,624,074	\$ 169,635,539
2005	81,442,102	60,907,334		142,349,436	9,072	4,070,892	146,429,400
2004	68,395,333	50,902,025		119,297,358	12,150	3,970,310	123,279,818
2003	62,788,746	49,384,916		112,173,662	7,808	3,672,425	115,853,895
2002	53,794,743	47,692,523		101,487,266	6,066	3,491,649	104,984,981
2001	46,544,264	38,389,936		84,934,200	5,155	3,221,712	88,161,067
2000	38,553,599	38,786,138		77,339,737	2,246	3,023,755	80,365,738
1999	34,389,038	33,236,136		67,625,174	3,145	2,728,897	70,357,216
1998	38,391,637	21,592,245		59,983,882	2,726	2,602,538	62,589,146
1997	0	0	64,966,674	64,966,674	1,703	2,996,094	67,964,471

**Changes in Net Assets**

YEAR	Total Additions to Plan Net Assets	Total Deductions to Plan Net Assets	Changes in Plan Net Assets
2006	\$ 153,938,930	\$ 169,635,539	\$ (15,696,609)
2005	137,106,130	146,429,400	(9,323,270)
2004	114,377,407	123,279,818	(8,902,411)
2003	135,345,162	115,853,895	19,491,267
2002	147,588,234	104,984,981	42,603,253
2001	137,733,275	88,161,067	49,572,208
2000	89,050,373	80,365,738	8,684,635
1999	83,054,541	70,357,216	12,697,325
1998	69,956,012	62,589,146	7,366,866
1997	66,310,895	67,964,471	(1,653,576)

\*\* Note: Prior to Jan 1, 1997 KTRS medical benefits were totally self-insured. After Jan 1, 1997 under 65 were covered under the state medical insurance pool. Over 65 remained KTRS self-insured.

**Distribution of Active Contributing Members  
as of June 30, 2006**

<b>By Age</b>			<b>By Service</b>		
Age	Male	Female	Years of Service	Male	Female
20-24	985	3,381	Less than 1	5,765	15,534
25-29	2,554	7,789	1-4	4,178	13,061
30-34	2,244	7,106	5-9	2,907	9,640
35-39	2,084	7,346	10-14	1,887	6,125
40-44	1,927	6,497	15-19	1,345	4,755
45-49	1,888	6,750	20-24	922	3,433
50-54	2,307	7,285	25-29	561	2,309
55-59	2,147	5,830	30-34	286	827
60-64	1,075	2,335	35 or more	87	118
65-69	469	926			
Over 70	258	557	TOTAL	17,938	55,802
TOTAL	17,938	55,802			

**Principal Participating Employers  
Current Year and Nine Years Ago**

	<b>2006</b>			<b>1997</b>		
	Covered Employees	Rank	Percentage of Total System	Covered Employees	Rank	Percentage of Total System
Jefferson County Schools	9,738	1	12.96%	6,739	1	12.72%
Fayette County Public Schools	3,974	2	5.29%	2,583	2	4.87%
Boone County Schools	1,546	3	2.06%	777	7	1.47%
Hardin County Schools	1,325	4	1.76%	961	4	1.81%
Kenton County Schools	1,177	5	1.57%	760	8	1.43%
Pike County Schools	1,142	6	1.52%	865	5	1.63%
Madison County Schools	1,125	7	1.50%	597	15	1.13%
Daviess County Schools	1,112	8	1.48%	691	10	1.30%
Bullitt County Schools	1,102	9	1.47%	666	11	1.26%
Warren County Schools	1,089	10	1.45%	719	9	1.36%
All Other *	51,809		68.95%	37,637		71.02%
Total (199 Employers)	75,139		100.00%	52,995		100.00%

**KTRS Schedule of Participating Employers**  
**School Districts: County Schools**

1. Adair	38. Fulton	74. Magoffin	110. Todd
2. Allen	39. Gallatin	75. Marion	111. Trigg
3. Anderson	40. Garrard	76. Marshall	112. Trimble
4. Ballard	41. Grant	77. Martin	113. Union
5. Barren	42. Graves	78. Mason	114. Warren
6. Bath	43. Grayson	79. McCracken	115. Washington
7. Bell	44. Green	80. McCreary	116. Wayne
8. Boone	45. Greenup	81. McLean	117. Webster
9. Bourbon	46. Hancock	82. Meade	118. Witley
10. Boyd	47. Hardin	83. Menifee	119. Wolfe
11. Boyle	48. Harlan	84. Mercer	120. Woodford
12. Bracken	49. Harrison	85. Metcalfe	
13. Breathitt	50. Hart	86. Monroe	
14. Breckinridge	51. Henderson	87. Montgomery	
15. Bullitt	52. Henry	88. Morgan	
16. Butler	53. Hickman	89. Muhlenberg	
17. Caldwell	54. Hopkins	90. Nelson	
18. Calloway	55. Jackson	91. Nicholas	
19. Campbell	56. Jefferson	92. Ohio	
20. Carlisle	57. Jessamine	93. Oldham	
21. Carroll	58. Johnson	94. Owen	
22. Carter	59. Kenton	95. Owsley	
23. Casey	60. Knott	96. Pendleton	
24. Christian	61. Knox	97. Perry	
25. Clark	62. Larue	98. Pike	
26. Clay	63. Laurel	99. Powell	
27. Clinton	64. Lawrence	100. Pulaski	
28. Crittenden	65. Lee	101. Robertson	
29. Cumberland	66. Leslie	102. Rockcastle	
30. Daviess	67. Letcher	103. Rowan	
31. Edmonson	68. Lewis	104. Russell	
32. Elliott	69. Lincoln	105. Scott	
33. Estill	70. Livingston	106. Shelby	
34. Fayette	71. Logan	107. Simpson	
35. Fleming	72. Lyon	108. Spencer	
36. Floyd	73. Madison	109. Taylor	
37. Franklin			

**School Districts: City Schools**

1. Anchorage	15. Covington	29. Harrodsburg	43. Pikeville
2. Ashland	16. Danville	30. Hazard	44. Pineville
3. Augusta	17. Dawson Springs	31. Jackson	45. Providence
4. Barbourville	18. Dayton	32. Jenkins	46. Raceland
5. Bardstown	19. East Bernstadt	33. Ludlow	47. Russell
6. Beechwood	20. Elizabethtown	34. Mayfield	48. Russellville
7. Bellevue	21. Eminence	35. Middlesboro	49. Science Hill
8. Berea	22. Erlanger-Elsmere	36. Monticello	50. Silver Grove
9. Bowling Green	23. Fairview	37. Murray	51. Somerset
10. Burgin	24. Fort Thomas	38. Newport	52. Southgate
11. Campbellsville	25. Frankfort	39. Owensboro	53. Walton-Verona
12. Caverna	26. Fulton	40. Paducah	54. West Point
13. Cloverport	27. Glasgow	41. Paintsville	55. Williamsburg
14. Corbin	28. Harlan	42. Paris	56. Williamstown

**KTRS Schedule of Participating Employers  
(continued)**

Universities & Community/Technical Colleges

1. Eastern Kentucky
2. Kentucky State
3. Morehead State
4. Murray State
5. Western Kentucky
6. Kentucky Community & Technical College System

**State of Kentucky/Other Organizations**

State of Kentucky

1. Education and Humanities Cabinet
2. Legislative Research Commission\*
3. Workforce Investment Cabinet
4. Cabinet for Families and Children\*
5. Finance and Administration Cabinet

Other Organizations

1. Education Professional Standards Board
2. Kentucky Education Association President
3. Kentucky Academic Association
4. Kentucky Educationals Development Cooperative
5. Kentucky High School Athletic Association
6. Kentucky School Boards Association
7. Kentucky Valley Educational Cooperative
8. Northern Kentucky Cooperative for Educational Services
9. Ohio Valley Educational Cooperative
10. West Kentucky Education Cooperative
11. Green River Regional Education Cooperative
12. Central Kentucky Special Education Cooperative

*\* According to Kentucky Revised Statute 161.607 (1), any member of the Kentucky Teachers' Retirement System who entered employment covered by the Kentucky Employees Retirement System, the State Police Retirement System, or the County Employees Retirement System prior to July 1, 1976, may retain membership in the Teachers' Retirement System instead of joining the new system. These organizations have members who are in this category. Once these members retire, the organization will no longer be considered a KTRS participating employer.*

**Distribution of Retirement Payments Worldwide**

**As of June 30, 2006**



97	Alabama	4	New Hampshire
2	Alaska	6	New Jersey
60	Arizona	15	New Mexico
24	Arkansas	38	New York
89	California	172	North Carolina
41	Colorado	6	North Dakota
12	Connecticut	451	Ohio
5	Delaware	19	Oklahoma
2	District of Columbia	20	Oregon
837	Florida	21	Pennsylvania
189	Georgia	1	Rhode Island
7	Hawaii	105	South Carolina
4	Idaho	7	South Dakota
66	Illinois	622	Tennessee
449	Indiana	139	Texas
12	Iowa	13	Utah
24	Kansas	1	Vermont
28	Louisiana	121	Virginia
7	Maine	25	Washington
25	Maryland	62	West Virginia
12	Massachusetts	21	Wisconsin
28	Michigan	3	Wyoming
16	Minnesota		
51	Mississippi		
55	Missouri		
4	Montana		
4	Nebraska		
15	Nevada		

**Additional Distribution Outside USA**

1	AUSTRALIA	1	PHILIPPINES
5	CANADA	1	SWITZERLAND
1	MILITARY APO		

TOTAL: Number of Out of State Payments ..... 4,046  
 TOTAL: Out of State Payments ..... \$ 77,519,765  
 TOTAL: Number of Payments ..... 39,692  
 GRAND TOTAL: Amount of Payments ..... \$ 1,031,676,184

## Distribution of Retirement Payments Statewide

as of June 30, 2006

<b>County Name</b>	<b>Total Payments</b>	<b>Number of Recipients</b>
Adair	\$4,227,388	172
Allen	3,424,791	136
Anderson	4,118,625	166
Ballard	2,208,142	82
Barren	9,184,343	347
Bath	2,604,373	120
Bell	8,600,748	347
Boone	17,426,302	609
Bourbon	4,020,497	162
Boyd	12,304,804	457
Boyle	8,179,390	315
Bracken	1,720,370	69
Breathitt	5,451,107	228
Breckinridge	4,185,521	151
Bullitt	9,301,712	319
Butler	2,006,327	84
Caldwell	3,820,364	146
Calloway	14,550,641	534
Campbell	14,919,992	524
Carlisle	1,028,799	42
Carroll	1,581,628	64
Carter	7,500,092	296
Casey	3,173,746	146
Christian	11,760,228	433
Clark	7,354,496	279
Clay	5,939,582	236
Clinton	2,890,751	113
Crittenden	1,432,706	60
Cumberland	1,897,100	68
Daviess	22,719,821	837
Edmonson	1,928,217	75
Elliott	1,272,288	59
Estill	2,736,354	107
Fayette	58,690,632	2,197
Fleming	3,363,341	137
Floyd	12,832,695	537
Franklin	16,716,691	744
Fulton	1,631,700	61
Gallatin	436,131	18
Garrard	3,630,486	134
Grant	3,475,863	126

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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*Distribution of Retirement Payments Statewide  
as of June 30, 2006 continued . . .*

County Name	Total Payments	Number of Recipients
Graves	8,376,233	305
Grayson	5,307,970	209
Green	2,816,511	109
Greenup	8,574,875	317
Hancock	1,686,417	62
Hardin	17,431,006	641
Harlan	9,557,374	376
Harrison	4,663,995	177
Hart	3,586,394	135
Henderson	8,421,200	327
Henry	3,738,555	144
Hickman	809,502	32
Hopkins	10,639,915	399
Jackson	2,689,993	121
Jefferson	161,847,140	5,311
Jessamine	5,913,799	236
Johnson	7,699,920	300
Kenton	17,413,705	649
Knott	5,088,797	216
Knox	5,705,147	231
Larue	3,641,470	123
Laurel	11,732,366	467
Lawrence	3,188,974	128
Lee	1,418,565	70
Leslie	3,187,150	136
Letcher	8,098,934	319
Lewis	4,058,561	155
Lincoln	6,362,704	244
Livingston	1,841,561	79
Logan	5,775,791	235
Lyon	2,216,925	89
Madison	29,733,574	1,034
Magoffin	3,477,382	145
Marion	3,559,885	136
Marshall	8,081,029	291
Martin	2,859,425	116
Mason	4,192,230	157
McCracken	15,494,385	571
McCreary	4,460,318	175
McLean	2,264,472	85
Meade	3,945,038	130

STATISTICAL SECTION

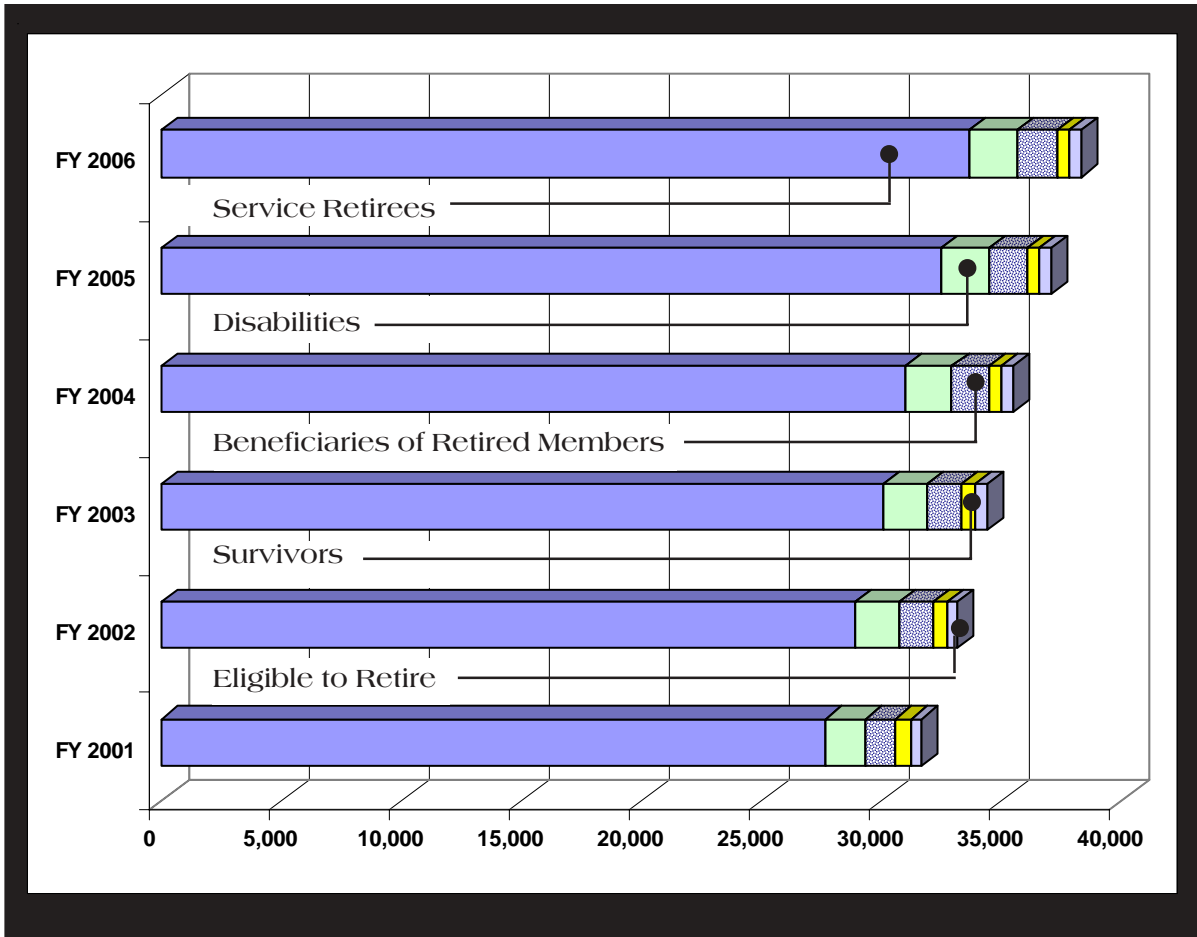
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*Distribution of Retirement Payments Statewide  
as of June 30, 2006 continued . . .*

County Name	Total Payments	Number of Recipients
Menifee	1,073,982	51
Mercer	5,031,550	212
Metcalfe	2,549,695	95
Monroe	3,624,549	144
Montgomery	5,913,898	226
Morgan	3,488,014	141
Muhlenberg	6,946,642	252
Nelson	7,837,345	281
Nicholas	1,427,979	57
Ohio	4,460,665	177
Oldham	9,708,599	335
Owen	1,737,793	74
Owsley	2,757,722	104
Pendleton	2,921,684	111
Perry	8,294,431	330
Pike	19,291,718	761
Powell	2,433,854	90
Pulaski	14,088,739	572
Robertson	505,216	22
Rockcastle	3,978,902	169
Rowan	11,100,405	414
Russell	4,436,857	173
Scott	7,356,197	264
Shelby	8,751,515	319
Simpson	3,228,054	128
Spencer	2,717,318	85
Taylor	5,655,591	228
Todd	2,054,064	86
Trigg	3,641,031	140
Trimble	1,453,875	43
Union	2,673,006	106
Warren	33,594,699	1,269
Washington	2,446,990	100
Wayne	5,390,142	212
Webster	2,817,554	114
Whitley	12,573,993	511
Wolfe	2,640,593	109
Woodford	5,743,587	222
<b>Total in Kentucky</b>	<b>\$ 954,156,419</b>	<b>35,646</b>



**Growth in Annuitants**  
as of June 30, 2006



Fiscal Year	Service Retirees	Disabilities	Beneficiaries of Retired Members	Survivors	Eligible to Retire
FY 2001	27,619	1,713	1,265	617	464
FY 2002	28,936	1,812	1,367	584	482
FY 2003	30,064	1,859	1,416	570	502
FY 2004	31,003	1,934	1,505	536	518
FY 2005	32,506	1,987	1,566	507	525
FY 2006	33,618	2,039	1,631	495	531

**Schedule of Annuitants by Type of Benefit  
as of June 30, 2006**

Amount of Monthly Benefit (\$)	Number of Annuitants	Type of Retirement*				
		1	2	3	4	5
1 - 500	2,975	2,041	19	450	202	263
501 - 1,000	2,748	2,022	233	5	488	0
1,001 - 1,500	4,177	3,272	341	0	564	0
1,501 - 2,000	4,913	4,088	484	4	337	0
2,001 - 2,500	8,023	7,156	595	17	255	0
2,501 - 3,000	7,217	6,810	229	12	166	0
3,001 - 3,500	3,933	3,775	89	2	67	0
3,501 - 4,000	2,119	2,036	39	4	40	0
4,001 - 4,500	1,134	1,106	7	0	21	0
4,501 - 5,000	596	581	2	1	12	0
5,001 & OVER	742	731	1	0	10	0
Total	38,577	33,618	2,039	495	2,162	263

**\*Type of Retirement**

- |   |  |
|---|--|
| 1 - Normal Retirement for Age & Service | 4 - Beneficiary Payment - Retired Member |
| 2 - Disability Retirement               | 5 - Disabled Adult Child                 |
| 3 - Survivor Payment - Active Member    |  |

Amount of Monthly Benefit (\$)	Option Selected*							
	1	2	3	4	5	6	7	None
1 - 500	1,377	366	240	57	8	344	127	456
501 - 1,000	1,433	327	226	147	10	288	236	81
1,001 - 1,500	2,244	535	373	192	14	401	319	99
1,501 - 2,000	2,551	550	431	170	5	622	401	183
2,001 - 2,500	3,762	767	639	273	10	1,348	875	349
2,501 - 3,000	3,775	745	560	225	9	1,029	776	98
3,001 - 3,500	2,010	429	361	138	7	541	416	31
3,501 - 4,000	1,015	219	225	82	7	302	259	10
4,001 - 4,500	535	131	114	78	7	143	125	1
4,501 - 5,000	275	65	87	34	2	55	77	1
5,001 & OVER	365	56	84	46	8	79	104	0
Total	19,342	4,190	3,340	1,442	87	5,152	3,715	1,309

**\*Option selected:**

- |   |  |
|---|--|
| 1 - Straight-life annuity with refundable balance           | 5 - Other payment - special option   |
| 2 - Period certain benefit and life thereafter              | 6 - Joint-survivor annuity with "pop-up" option                                  |
| 3 - Joint-survivor annuity                                  | 7 - Joint-survivor annuity, one-half benefit to beneficiary with "pop-up" option |
| 4 - Joint-survivor annuity, one-half benefit to beneficiary |  |

KENTUCKY TEACHERS' RETIREMENT SYSTEM

**Defined Benefit Plan**  
**Average Benefit Payments for the Past Ten Years**  
 By Years of Service Credit

Retirement Effective Dates	00-4.99	05-9.99	10-14.99	15-19.99	20-24.99	25-29.99	30 > =	TOTAL
07/01/1996 TO 06/30/1997								
Average monthly benefit	\$108	\$370	\$782	\$1,035	\$1,541	\$2,084	\$2,535	
Average final average salary	\$3,279	\$2,582	\$3,052	\$2,994	\$3,317	\$3,509	\$3,724	
Number of retired members	28	58	54	68	139	975	626	1,948
07/01/1997 TO 06/30/1998								
Average monthly benefit	\$148	\$415	\$732	\$1,108	\$1,597	\$2,175	\$2,762	
Average final average salary	\$3,807	\$2,922	\$2,843	\$3,153	\$3,450	\$3,652	\$4,071	
Number of retired members	25	73	69	85	154	1,135	524	2,065
07/01/1998 TO 06/30/1999								
Average monthly benefit	\$117	\$420	\$735	\$1,075	\$1,723	\$2,303	\$2,907	
Average final average salary	\$2,995	\$3,042	\$2,953	\$3,087	\$3,630	\$3,805	\$4,248	
Number of retired members	31	71	80	81	115	1,133	497	2,008
07/01/1999 TO 06/30/2000								
Average monthly benefit	\$195	\$444	\$840	\$1,232	\$1,721	\$2,414	\$3,052	
Average final average salary	\$3,764	\$3,183	\$3,198	\$3,390	\$3,573	\$3,958	\$4,461	
Number of retired members	54	82	74	82	95	1,180	473	2,040
07/01/2000 TO 06/30/2001								
Average monthly benefit	\$145	\$402	\$881	\$1,283	\$1,779	\$2,472	\$3,246	
Average final average salary	\$3,695	\$2,842	\$3,444	\$3,550	\$3,807	\$4,024	\$4,707	
Number of retired members	48	73	86	85	143	1,008	486	1,929
07/01/2001 TO 06/30/2002								
Average monthly benefit	\$204	\$408	\$790	\$1,296	\$1,898	\$2,552	\$3,407	
Average final average salary	\$4,143	\$2,950	\$3,312	\$3,613	\$3,920	\$4,115	\$4,884	
Number of retired members	65	128	82	116	107	1,019	574	2,091
07/01/2002 TO 06/30/2003								
Average monthly benefit	\$205	\$480	\$940	\$1,344	\$1,940	\$2,715	\$3,592	
Average final average salary	\$4,301	\$3,380	\$3,714	\$3,798	\$4,078	\$4,378	\$5,121	
Number of retired members	58	83	98	103	155	837	508	1,842
07/01/2003 TO 06/30/2004								
Average monthly benefit	\$220	\$474	\$839	\$1,444	\$1,978	\$2,758	\$3,486	
Average final average salary	\$5,243	\$3,357	\$3,349	\$3,936	\$4,182	\$4,425	\$5,062	
Number of retired members	43	84	98	96	145	818	405	1,689
07/01/2004 TO 06/30/2005								
Average monthly benefit	\$187	\$528	\$906	\$1,488	\$2,037	\$2,892	\$3,860	
Average final average salary	\$4,353	\$3,511	\$3,647	\$4,055	\$4,317	\$4,602	\$5,275	
Number of retired members	55	98	107	106	145	811	875	2,197
07/01/2005 TO 06/30/2006								
Average monthly benefit	\$202	\$473	\$1,109	\$1,493	\$2,136	\$2,998	\$4,063	
Average final average salary	\$4,106	\$3,253	\$4,052	\$4,117	\$4,537	\$4,721	\$5,490	
Number of retired members	44	105	106	132	193	689	604	1,873

Year Ended June 30, 2006

**Medical Insurance Plan**

Average Insurance Premium Supplements for the Last Six Years

	Years of Service Credit				TOTAL
	00-9.99	10-14.99	15-19.99	20>=	
<b>Retirement Effective Dates</b>					
07/01/2000 TO 06/30/2001					
Average monthly supplement	\$179.71	\$165.08	\$201.72	\$233.51	
Number of retired members	42	69	96	1,634	1,841
07/01/2001 TO 06/30/2002					
Average monthly supplement	\$128.78	\$167.74	\$201.48	\$252.15	
Number of retired members	59	62	99	1,694	1,914
07/01/2002 TO 06/30/2003					
Average monthly supplement	\$106.62	\$142.57	\$212.81	\$277.64	
Number of retired members	34	59	91	1,457	1,641
07/01/2003 TO 06/30/2004					
Average monthly supplement	\$100.50	\$148.85	\$219.41	\$289.98	
Number of retired members	30	59	82	1,365	1,536
07/01/2004 TO 06/30/2005					
Average monthly supplement	\$138.29	\$214.32	\$305.39	\$394.92	
Number of retired members	36	70	93	1,768	1,967
07/01/2005 TO 06/30/2006					
Average monthly supplement	\$161.03	\$241.76	\$362.31	\$487.23	
Number of retired members	28	49	106	1,440	1,623

KENTUCKY TEACHERS' RETIREMENT SYSTEM

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**Summary of Fiscal Year 2005-2006  
Retiree Sick Leave Payments**

**ACTUARIAL RATE**

Grand Total Members Retiring	1,869
Total members receiving sick leave payments	1,360
Total amount of sick leave payments @ 9.855% contribution rate	\$ 16,112,946.45
Average payment per retiree	\$ 11,847.75
Total increase in final average salary base	\$ 4,669,286.41
Average increase in FAS	\$ 3,433.30
Total service credit of retirees	37,013.25
Average service credit of retirees	<u>27.22</u>

**AVERAGE YEARLY ANNUITY** \$ 2,263.92

**AVERAGE MONTHLY ANNUITY** \$ 188.66

**ANTICIPATED LIFETIME PAYOUT OF ADDITIONAL ANNUITY** \$ 37,665,129.84

**Funding of Additional Payments**

Member contributions 9.855% x Sick Leave Payment	\$ 1,587,930.87
State Contributions 13.105% x Sick Leave Payment	<u>2,111,601.63</u>
<b>TOTAL Member-State Contributions</b>	<b>3,699,532.50</b>

**DEFICIT**

Anticipated additional payout	37,665,129.84
Less total member & state contributions	<u>3,699,532.50</u>
Subtotal unfunded debt	33,965,597.34
Less current year appropriations	<u>4,339,500.00</u>
<b>TOTAL DEFICIT</b>	<b>\$ 29,626,097.34 *</b>

\* NOTE: Actuarial factors used for sick leave calculations changed effective July 1, 1998. Sick leave deficits are amortized over 20 year periods.

**Summary of State Match  
and Supplemental Appropriations  
for Member Contributions to Teachers' Retirement System  
for Fiscal Year Ended June 30, 2006**

Fiscal Year	Total Member Contributions	Employer/ Federal Payments	Required State Match Contributions	Required Supplemental Appropriation	Required Sick Leave Payments	Total State Appropriation	(Deficit) Surplus State Funding
1944-48	3,184,178		3,184,178			3,039,017	(145,160)
1948-52	4,951,458		4,951,458			5,090,848	(139,390)
1952-56	7,267,163		7,267,163			6,494,102	(773,062)
1956-60	14,970,961		14,970,961			14,963,272	(7,689)
1960-64	25,945,897		25,945,897			25,938,763	(7,134)
1964-68	49,957,299	2,042,014	47,915,285			45,317,694	(2,597,591)
1968-72	82,922,869	6,044,865	76,878,005			80,091,951	3,213,946
1972-76	120,349,350	8,019,216	112,330,134			111,665,685	(664,449)
1976-80	189,072,371	12,044,186	177,028,185	75,010,028		256,784,030	4,745,817
1980-84	272,744,772	16,334,937	256,409,836	109,622,111	5,197,234	378,667,011	7,437,831
1984-88	413,932,416	21,417,604	392,514,811	141,251,827	13,341,243	515,932,177	(31,175,706)
1988-92	602,399,432	119,352,211	483,347,221	133,545,987	28,978,117	634,358,200	(11,537,557)
1992-96	756,817,769	154,296,351 <sup>(2)</sup>	602,521,418	213,030,177	53,308,591	854,138,311	(14,751,875)
1996-00	863,954,020	171,037,889	692,916,131	245,400,594	43,209,004	990,501,344	8,975,615
2000-04	999,971,551	200,041,662	799,935,889	289,439,321	see (1)	1,065,262,116	(24,113,095)
2004-05	274,249,089	63,618,098	210,630,991	79,018,035		293,364,324	3,715,298
2005-06	289,063,930	66,462,471	222,601,459	83,319,537		310,182,549	4,261,553

(1) The state appropriations for the sick leave deficit started being amortized over 15 years in the year ended June 1999 through the year ended June 2002. Starting the fiscal year 2003 the sick leave deficits were amortized over 20 years.

(2) Beginning with the 1988-89 fiscal year, the Department of Education and the state universities were responsible for matching their members' contributions with the state reimbursing the respective agencies in their normal budget appropriation.

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