

**REPORT OF THE AUDIT OF THE  
KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**

**For The Fiscal Year Ended  
June 30, 2016**



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CONTENTS

PAGE

INDEPENDENT AUDITOR’S REPORT .....	1
MANAGEMENT’S DISCUSSION AND ANALYSIS .....	7
STATEMENT OF FIDUCIARY NET POSITION .....	13
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION .....	15
NOTES TO THE FINANCIAL STATEMENTS.....	19
REQUIRED SUPPLEMENTARY INFORMATION .....	45
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENT PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i> .....	55





MIKE HARMON  
AUDITOR OF PUBLIC ACCOUNTS

Board of Trustees  
Kentucky Judicial Form Retirement System

Independent Auditor's Report

**Report on the Financial Statements**

We have audited the accompanying financial statements of the Kentucky Judicial Form Retirement System, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Kentucky Judicial Form Retirement System's basic financial statements as listed in the table of contents.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



Board of Trustees  
Kentucky Judicial Form Retirement System

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Kentucky Judicial Form Retirement System as of June 30, 2016, and the changes in fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

***Emphasis-of-Matter***

*Reporting Entity*

As discussed in Note 1, the financial statements present only the Kentucky Judicial Form Retirement System, and are not intended to present fairly the financial position of the Commonwealth of Kentucky, or the results of its operations in conformity with accounting principles generally accepted in the United States of America.

***Other Matters***

*Comparative Financial Statements*

The financial statements of the Kentucky Judicial Form Retirement System for the year ended June 30, 2015, were audited by other auditors whose report dated December 10, 2015, stated that the fiduciary net position as of June 30, 2015 and changes in fiduciary net position for the year then ended were in conformity with accounting principles generally accepted in the United States of America. The financial statements for the year then ended, were audited by other auditors whose report, dated December 10, 2015, expressed an unmodified opinion on those statements.

*Report on Supplementary Information*

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 7 through 10, and the schedules of changes in net pension liability and related ratios, schedules of contributions, schedules of investment returns, schedules of funding progress-medical insurance, and schedules of employer contributions-medical insurance on pages 45 through 51, are presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, or other knowledge we obtained during our audit of the basic financial statements.

Board of Trustees  
Kentucky Judicial Form Retirement System

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated November 23, 2016, on our consideration of the Kentucky Judicial Form Retirement System's internal control over financial reporting and on our test of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Kentucky Judicial Form Retirement System's internal control over financial reporting and compliance.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mike Harmon", with a long horizontal line extending to the right.

Mike Harmon  
Auditor of Public Accounts

November 23, 2016





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



**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
June 30, 2016**

As management of the Kentucky Judicial Form Retirement System (System), a component unit of the Commonwealth of Kentucky, we offer the readers of the System's financial statements this narrative overview and analysis of the financial performance of the System for the fiscal years ended June 30, 2016 and 2015. The two retirement plans within the System are the Kentucky Judicial Retirement Plan and the Kentucky Legislators Retirement Plan (collectively, the Plans). We encourage readers to read it in conjunction with the System's financial statements and the accompanying notes.

**USING THIS FINANCIAL REPORT**

Because of the long-term nature of a defined benefit pension plan, financial statements alone cannot provide sufficient information to properly reflect a plan's ongoing plan perspective. The Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position (pages 13 through 16) provide information about the activities of the Plans as a whole. The Kentucky Judicial Retirement Plan is the fiduciary of funds held in trust for its members, and the Kentucky Legislators Retirement Plan is the fiduciary of funds held in trust for its members.

The Schedules of Changes in Net Pension Liability and Related Ratios (pages 45 and 46) include information about the actuarially funded status of each defined benefit plan, including the sources of changes in the net pension liability and the components of the net pension liability and related ratios. The Schedules of Contributions - Defined Benefit Pension (pages 47 and 48) include information about the actuarially determined contributions, contributions to each defined benefit plan and related ratios. The Schedules of Investment Returns - Defined Benefit Pension (on page 49) include information on the rate of return on defined benefit pension plan investments.

The Schedules of Funding Progress - Medical Insurance (page 50) include 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 insurance premiums when due. The Schedules of Employer Contributions - Medical Insurance (page 51) present historical trend information about the annual statutorily required appropriations. These schedules provide information that contributes to understanding the changes over time in the funded status of the Plans.

**Medical Insurance**

For purposes of disclosures required by Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, assets have been allocated between pension and retiree medical liabilities on the basis of accrued liability as of July 1, 2007. This amount has then been brought forward from that date based on actual cash flows and a prorated allocation of investment return.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

**June 30, 2016**

**(Continued)**

**FINANCIAL HIGHLIGHTS**

**Judicial Retirement Plan**

In the fiscal years ended June 30, 2016 and 2015, the Judicial Retirement Plan experienced:

- An increase in fiduciary net position of \$4.7 million, from \$333.1 million to \$337.8 million in 2016, and an increase of \$26.9 million, from \$306.2 million to \$333.1 million in 2015. The increase in both years is primarily due to investment earnings.
- A \$121,000 decrease and a \$3.6 million increase in employer contributions during fiscal years 2016 and 2015, respectively. The decrease/increase each year is directly related to the amount appropriated by the Commonwealth of Kentucky.
- A decrease in net investment income of \$21.2 million from \$32.0 million in 2015, to \$10.8 million in 2016, and a decrease of \$9.7 million from \$41.7 million in fiscal year 2014, to \$32.0 million in fiscal year 2015. The change each year is due primarily to the amount of appreciation of investments held.
- An increase of \$621,000 and \$517,000 in benefit payments during fiscal years 2016 and 2015 respectively, with aggregate benefit payments of \$22.8 million and \$22.2 million in fiscal years 2016 and 2015, respectively.

	June 30,		June 30,		2014
	2016	% Increase (Decrease)	2015	% Increase (Decrease)	
<b>Summary of Fiduciary Net Position</b>					
Cash and investments	\$ 336,474,266	1.39%	\$ 331,875,875	8.75%	\$ 305,164,800
Receivables	1,345,443	14.03%	1,179,933	11.76%	1,055,740
Fiduciary net position	<u>\$ 337,819,709</u>	1.43%	<u>\$ 333,055,808</u>	8.76%	<u>\$ 306,220,540</u>
	2016	% Increase (Decrease)	2015	% Increase (Decrease)	2014
<b>Summary of Changes in Fiduciary Net Position</b>					
Additions:					
Employer contributions	16,578,846	(0.73%)	16,700,146	27.16%	13,132,720
Member contributions	1,895,026	(8.84%)	2,078,772	(28.82%)	2,920,311
Net investment income	10,831,020	(66.16%)	32,010,565	(23.29%)	41,727,616
Appropriations for administrative expense	525,821	(0.09%)	526,303	4.92%	501,643
Litigation proceeds	10,610	898.12%	1,063	(74.71%)	4,204
Total additions	<u>29,841,323</u>	(41.85%)	<u>51,316,849</u>	(11.96%)	<u>58,286,494</u>
Deductions:					
Benefit payments	22,857,157	2.80%	22,235,609	2.38%	21,718,323
Insurance premiums	1,948,704	(1.06%)	1,969,518	(3.40%)	2,038,819
Administrative expenses	271,561	0.85%	269,265	3.62%	259,857
Refund of member contributions		(100.00%)	7,189	(91.94%)	89,242
Total deductions	<u>25,077,422</u>	2.43%	<u>24,481,581</u>	1.56%	<u>24,106,241</u>
Change in fiduciary net position	<u>4,763,901</u>	(82.25%)	<u>26,835,268</u>	(21.49%)	<u>34,180,253</u>
Fiduciary net position, beginning of year	<u>333,055,808</u>		<u>306,220,540</u>		<u>272,040,287</u>
Fiduciary net position, end of year	<u>\$ 337,819,709</u>		<u>\$ 333,055,808</u>		<u>\$ 306,220,540</u>

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

**June 30, 2016**

**(Continued)**

Legislators Retirement Plan

In the fiscal years ended June 30, 2016 and 2015, the Legislators Retirement Plan experienced:

- An increase in fiduciary net position of \$2.4 million from \$97.4 million to \$99.8 million in fiscal year 2016, and an increase of \$8.2 million, from \$89.2 million to \$97.4 million during fiscal year 2015. The increase in both years is primarily due to earnings on investments.
- An increase of \$11,000 and \$1.6 million in employer contributions during fiscal years 2016 and 2015, respectively. The increase each year is directly related to the amount appropriated by the Commonwealth of Kentucky.
- A decrease in net investment income of \$5.6 million from \$9.0 million in 2015 to \$3.4 million in 2016, and \$3.9 million from \$12.9 million in 2014 to \$9.0 million during fiscal year 2015. The change each year is due primarily to the amount of appreciation of investments held.
- An increase of \$315,000 and \$138,000 in benefit payments during fiscal years 2016 and 2015, respectively. Benefit payments approximate \$4.0 million and \$3.7 million during fiscal years 2016 and 2015, respectively.

	June 30,				
	2016	% Increase (Decrease)	2015	% Increase (Decrease)	2014
<u>Summary of Fiduciary Net Position</u>					
Cash and investments	\$ 99,451,011	2.45%	\$ 97,068,945	9.23%	\$ 88,870,254
Receivables	376,072	7.12%	351,061	3.31%	339,798
Fiduciary net position	<u>99,827,083</u>	2.47%	<u>97,420,006</u>	9.20%	<u>89,210,052</u>
	2016	% Increase (Decrease)	2015	% Increase (Decrease)	2014
<u>Summary of Changes in Fiduciary Net Position</u>					
Additions:					
Employer contributions	3,386,182	0.32%	3,375,296	84.95%	1,824,956
Member contributions	339,631	46.16%	232,363	(14.90%)	273,045
Net investment income	3,352,005	(62.72%)	8,992,173	(30.52%)	12,942,799
Appropriations for administrative expense	186,800	2.58%	182,100	11.51%	163,300
Litigation proceeds	1,933			(100.00%)	1,667
Total additions	<u>7,266,551</u>	(43.15%)	<u>12,781,932</u>	(15.94%)	<u>15,205,767</u>
Deductions:					
Benefit payments	3,996,690	8.55%	3,681,805	3.88%	3,544,284
Insurance premiums	661,292	(4.16%)	690,019	(5.53%)	730,400
Administrative expenses	201,492	5.10%	191,708	(12.15%)	218,218
Refund of member contributions		(100.00%)	8,446		
Total deductions	<u>4,859,474</u>	6.29%	<u>4,571,978</u>	1.76%	<u>4,492,902</u>
Change in fiduciary net position	<u>2,407,077</u>	(70.68%)	<u>8,209,954</u>	(23.36%)	<u>10,712,865</u>
Fiduciary net position, beginning of year	<u>97,420,006</u>		<u>89,210,052</u>		<u>78,497,187</u>
Fiduciary net position, end of year	<u>\$ 99,827,083</u>		<u>\$ 97,420,006</u>		<u>\$ 89,210,052</u>

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
June 30, 2016  
(Continued)**

**DISCUSSION OF CURRENTLY KNOWN FACTS, DECISIONS, OR CONDITIONS**

Accounting standards require that the Statement of Fiduciary Net Position state asset value at fair value and include only benefits and refunds due to 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 and medical insurance plans is provided in the Schedules of Changes in Net Pension Liability and Related Ratios and Schedules of Funding Progress - Medical Insurance, respectively.

Annual contributions of the Commonwealth are set by the Kentucky Revised Statutes. During the years ended June 30, 2015 and June 30, 2016, the General Assembly appropriated the statutorily-required annual contributions to both the Judicial Plan and the Legislators Plan. During the years ended June 30, 2011 through June 30, 2014, the General Assembly suspended state statutes so that contributions could be reduced. In the Judicial Plan, the reductions were: FY11, 44%; FY12, 48%; FY13, 69%; and, FY 14, 71%. In the Legislators Plan, the reductions were: FY11, 44%; FY12, 48%; FY13, 53%; and, FY 14, 57%. The Schedules of Contributions - Defined Benefit Pension and Schedules of Employer Contributions - Defined Benefit Medical Insurance (on pages 47, 48 and 51) indicate the contributions that have been made while the statutes were suspended.

**CONTACTING THE SYSTEM**

This financial report is designed to provide a general overview of the System's finances. If you have any questions concerning the information provided, contact the Kentucky Judicial Form Retirement System at 305 Ann Street, Frankfort, KY 40601.

## **FINANCIAL STATEMENTS**





**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
STATEMENT OF FIDUCIARY NET POSITION**

**June 30, 2016**

	Kentucky Judicial Retirement Plan			Kentucky Legislators Retirement Plan			System Total
	Pension	Medical Insurance	Total	Pension	Medical Insurance	Total	
Cash and cash equivalents	\$ 100,941	\$ 26,532	\$ 127,473	\$ 17,754	\$ 10,841	\$ 28,595	\$ 156,068
Receivables:							
Accrued interest receivable	738,051	193,993	932,044	171,089	104,468	275,557	1,207,601
Dividends receivable	221,815	58,303	280,118	50,851	31,050	81,901	362,019
Members' contributions receivable	107,592	25,689	133,281	18,579	35	18,614	151,895
Total receivables	1,067,458	277,985	1,345,443	240,519	135,553	376,072	1,721,515
Investments at fair value:							
Investments held by State Treasury	55,414	14,565	69,979	57,292	34,983	92,275	162,254
Governmental securities	18,620,982	4,894,432	23,515,414	2,882,672	1,760,182	4,642,854	28,158,268
Foreign governmental securities	2,155,352	566,523	2,721,875	405,592	247,658	653,250	3,375,125
Corporate notes	47,276,849	12,426,483	59,703,332	12,908,040	7,881,753	20,789,793	80,493,125
Common stock	198,231,924	52,104,269	250,336,193	45,476,144	27,768,100	73,244,244	323,580,437
Total investments	266,340,521	70,006,272	336,346,793	61,729,740	37,692,676	99,422,416	435,769,209
Fiduciary net position-restricted for pension and other post-employment benefits	\$ 267,508,920	\$ 70,310,789	\$ 337,819,709	\$ 61,988,013	\$ 37,839,070	\$ 99,827,083	\$ 437,646,792

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

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
STATEMENT OF FIDUCIARY NET POSITION**

**June 30, 2015**

	Kentucky Judicial Retirement Plan			Kentucky Legislators Retirement Plan			System Total
	Pension	Medical Insurance	Total	Pension	Medical Insurance	Total	
Cash and cash equivalents	\$ 19,962	\$ 5,168	\$ 25,130	\$ 36,823	\$ 22,777	\$ 59,600	\$ 84,730
Receivables:							
Accrued interest receivable	633,862	164,100	797,962	162,822	100,715	263,537	1,061,499
Dividends receivable	189,056	48,945	238,001	43,027	26,614	69,641	307,642
Members' contributions receivable	114,363	29,607	143,970	11,049	6,834	17,883	161,853
Total receivables	<u>937,281</u>	<u>242,652</u>	<u>1,179,933</u>	<u>216,898</u>	<u>134,163</u>	<u>351,061</u>	<u>1,530,994</u>
Investments at fair value:							
Investments held by State Treasury	13,309	3,446	16,755	85,919	53,146	139,065	155,820
Governmental securities	22,094,256	5,728,277	27,822,533	3,295,364	2,169,985	5,465,349	33,287,882
Foreign governmental securities	2,169,651	561,699	2,731,350	405,005	250,519	655,524	3,386,874
Corporate notes	42,792,625	11,078,550	53,871,175	11,547,432	7,142,762	18,690,194	72,561,369
Common stock	196,529,549	50,879,383	247,408,932	44,520,612	27,538,601	72,059,213	319,468,145
Total investments	<u>263,599,390</u>	<u>68,251,355</u>	<u>331,850,745</u>	<u>59,854,332</u>	<u>37,155,013</u>	<u>97,009,345</u>	<u>428,860,090</u>
Fiduciary net position-restricted for pension and other post-employment benefits	<u>\$ 264,556,633</u>	<u>\$ 68,499,175</u>	<u>\$ 333,055,808</u>	<u>\$ 60,108,053</u>	<u>\$ 37,311,953</u>	<u>\$ 97,420,006</u>	<u>\$ 430,475,814</u>

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

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION**

**For the Year Ended June 30, 2016**

	Kentucky Judicial Retirement Plan			Kentucky Legislators Retirement Plan			System Total
	Pension	Medical Insurance	Total	Pension	Medical Insurance	Total	
<u>Additions</u>							
Contributions:							
Employer	\$ 15,295,222	\$ 1,283,624	\$ 16,578,846	\$ 3,380,975	\$ 5,207	\$ 3,386,182	\$ 19,965,028
Member	1,737,100	157,926	1,895,026	334,710	4,921	339,631	2,234,657
Total Contributions	<u>17,032,322</u>	<u>1,441,550</u>	<u>18,473,872</u>	<u>3,715,685</u>	<u>10,128</u>	<u>3,725,813</u>	<u>22,199,685</u>
Appropriations for administrative expense	415,937	109,884	525,821	120,886	65,914	186,800	712,621
Securities litigation proceeds	8,393	2,217	10,610	1,251	682	1,933	12,543
<u>Investments</u>							
Net appreciation (realized and unrealized)	2,522,832	666,490	3,189,322	688,355	375,331	1,063,686	4,253,008
Interest	1,656,343	437,578	2,093,921	384,081	209,423	593,504	2,687,425
Dividends	4,589,663	1,212,513	5,802,176	1,096,803	598,040	1,694,843	7,497,019
Total investment income	<u>8,768,838</u>	<u>2,316,581</u>	<u>11,085,419</u>	<u>2,169,239</u>	<u>1,182,794</u>	<u>3,352,033</u>	<u>14,437,452</u>
Less investment expenses	201,236	53,163	254,399	18	10	28	254,427
Net investment income	<u>8,567,602</u>	<u>2,263,418</u>	<u>10,831,020</u>	<u>2,169,221</u>	<u>1,182,784</u>	<u>3,352,005</u>	<u>14,183,025</u>
Total additions	<u>26,024,254</u>	<u>3,817,069</u>	<u>29,841,323</u>	<u>6,007,043</u>	<u>1,259,508</u>	<u>7,266,551</u>	<u>37,107,874</u>
<u>Deductions</u>							
Benefit payments	22,857,157		22,857,157	3,996,690		3,996,690	26,853,847
Medical insurance premiums		1,948,704	1,948,704		661,292	661,292	2,609,996
Administrative expense	214,810	56,751	271,561	130,393	71,099	201,492	473,053
Total deductions	<u>23,071,967</u>	<u>2,005,455</u>	<u>25,077,422</u>	<u>4,127,083</u>	<u>732,391</u>	<u>4,859,474</u>	<u>29,936,896</u>
Net increase in plan net position	2,952,287	1,811,614	4,763,901	1,879,960	527,117	2,407,077	7,170,978
Fiduciary net position-restricted, beginning of year	<u>264,556,633</u>	<u>68,499,175</u>	<u>333,055,808</u>	<u>60,108,053</u>	<u>37,311,953</u>	<u>97,420,006</u>	<u>430,475,814</u>
Fiduciary net position-restricted, end of year	<u>\$ 267,508,920</u>	<u>\$ 70,310,789</u>	<u>\$ 337,819,709</u>	<u>\$ 61,988,013</u>	<u>\$ 37,839,070</u>	<u>\$ 99,827,083</u>	<u>\$ 437,646,792</u>

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

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION**

**For the Year Ended June 30, 2015**

	Kentucky Judicial Retirement Plan			Kentucky Legislators Retirement Plan			System Total
	Pension	Medical Insurance	Total	Pension	Medical Insurance	Total	
<u>Additions</u>							
Contributions:							
Employer	\$ 15,404,863	\$ 1,295,283	\$ 16,700,146	\$ 3,375,296	\$	\$ 3,375,296	\$ 20,075,442
Member	1,911,096	167,676	2,078,772	227,774	4,589	232,363	2,311,135
Total Contributions	17,315,959	1,462,959	18,778,918	3,603,070	4,589	3,607,659	22,386,577
Appropriations for administrative expense	417,736	108,567	526,303	112,459	69,641	182,100	708,403
Securities litigation proceeds	844	219	1,063				1,063
Investments							
Net appreciation (realized and unrealized)	19,957,023	5,186,661	25,143,684	4,298,908	2,662,293	6,961,201	32,104,885
Interest	1,652,493	429,469	2,081,962	334,001	206,845	540,846	2,622,808
Dividends	4,002,213	1,040,141	5,042,354	920,231	569,895	1,490,126	6,532,480
Total investment income	25,611,729	6,656,271	32,268,000	5,553,140	3,439,033	8,992,173	41,260,173
Less investment expenses	204,331	53,104	257,435				257,435
Net investment income	25,407,398	6,603,167	32,010,565	5,553,140	3,439,033	8,992,173	41,002,738
Total additions	43,141,937	8,174,912	51,316,849	9,268,669	3,513,263	12,781,932	64,098,781
<u>Deductions</u>							
Benefit payments	22,235,609		22,235,609	3,681,805		3,681,805	25,917,414
Medical insurance premiums		1,969,518	1,969,518		690,019	690,019	2,659,537
Administrative expense	213,721	55,544	269,265	118,390	73,318	191,708	460,973
Refund of member contributions	5,706	1,483	7,189	5,216	3,230	8,446	15,635
Total deductions	22,455,036	2,026,545	24,481,581	3,805,411	766,567	4,571,978	29,053,559
Net increase in plan net position	20,686,901	6,148,367	26,835,268	5,463,258	2,746,696	8,209,954	35,045,222
Fiduciary net position-restricted, beginning of year	243,869,732	62,350,808	306,220,540	54,644,795	34,565,257	89,210,052	395,430,592
Fiduciary net position-restricted, end of year	\$ 264,556,633	\$ 68,499,175	\$ 333,055,808	\$ 60,108,053	\$ 37,311,953	\$ 97,420,006	\$ 430,475,814

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

## **NOTES TO THE FINANCIAL STATEMENTS**



**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**

**Note 1 – Summary of Significant Accounting Policies**

Financial Reporting Entity

Under the provisions of the Kentucky Revised Statutes, the Kentucky Judicial Retirement Plan (Judicial Plan) and the Kentucky Legislators Retirement Plan (Legislators Plan) (collectively, Plans) have the same Board of Trustees and are coordinated administratively by the Board of Trustees, as the Kentucky Judicial Form Retirement System (System). The Board of Trustees of the System consists of eight members, three of whom are appointed by the Supreme Court, two by the Governor, one by the President of the Kentucky Senate, one by the Speaker of the Kentucky House of Representatives, and one by the President and Speaker jointly. Although the Plans share a common Board of Trustees, each Plan maintains its own investments and pays benefits to its members only from its own assets. Each Plan has a defined benefit and a hybrid cash balance component (Note 2).

The System is a component unit of the Commonwealth of Kentucky (Commonwealth). The Plans' fiduciary net position and changes in fiduciary net position are included in the Commonwealth's Comprehensive Annual Financial Report (CAFR) as a pension trust fund in the fiduciary funds financial statement. Financial statements of the Commonwealth and its component units that form the Commonwealth reporting entity have been issued separately and are audited by the Auditor of Public Accounts.

Basis of Accounting

The financial statements are prepared on the accrual basis of accounting. The System follows accounting standards established by the Governmental Accounting Standards Board (GASB).

Management's Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

This amount represents cash on deposit and investments with original maturities of less than three months, held in the name of the System with the Treasurer of the Commonwealth, the investment manager, or the custodian and used for payment of administrative expenses, benefit liabilities or pending investment transactions.

Member Contributions

Member contributions to the Plans are recognized when due and the employer has made a formal commitment to provide the contributions.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 1 – Summary of Significant Accounting Policies (Continued)**

Benefit Payments and Refunds

Benefit payments and refunds are recognized when due and payable in accordance with the terms of the Plans.

Valuation of Investments

The Plans' investments are stated at fair value. Quoted market prices are used to value investments.

**Note 2 – Plan Description and Contribution Information**

Kentucky Judicial Retirement Plan

*Membership – Defined Benefit Plan*

Total membership in the defined benefit plan of the Kentucky Judicial Retirement Plan (Judicial Defined Benefit Plan) consisted of the following at July 1, 2015, the date of the last actuarial valuation, and as of June 30, 2016:

	<u>July 1, 2015</u>	<u>June 30, 2016</u>
Retirees and beneficiaries receiving benefits	329	330
Terminated plan members-vested	20	18
Active plan members	247	237
Total	<u>596</u>	<u>585</u>
Number of participating employers	<u>1</u>	<u>1</u>

*Membership – Hybrid Cash Balance Plan*

Membership in the hybrid cash balance plan of the Kentucky Judicial Retirement Plan (Judicial Hybrid Cash Balance Plan) consisted of 16 individuals at June 30, 2015, and 17 individuals at June 30, 2016.

*Plan Description – Defined Benefit Plan*

The Judicial Defined Benefit Plan is a single-employer defined benefit plan that provides retirement benefits and medical insurance premium supplements, and covers the District, Circuit, Court of Appeals, and Supreme Court judges.



**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 2 – Plan Description and Contribution Information (Continued)**

The Judicial Defined Benefit Plan provides retirement, disability, and death benefits in accordance with statutory formulas to plan members and their beneficiaries. Prior to June 30, 2009, cost-of-living adjustments (COLA), keyed to the Consumer Price Index, were provided on July 1 of each year. Commencing in 2009, the COLA on July 1 of each year is 1.50%. The COLA created in 2009 was suspended by legislative action in 2012, and no COLA's have since been granted. By legislative action in 2013, the statute was amended to provide that each July 1, a recipient of a monthly pension benefit from the Judicial Defined Benefit Plan shall receive a 1.50% cost-of-living adjustment (pro-rated for the first year, if the recipient has been retired for less than one year) if:

- 1) The funding level of the Judicial Defined Benefit Plan is greater than 100% and subsequent legislation authorizes the use of any surplus actuarial assets to provide for the increase; and
- 2) The Kentucky General Assembly appropriates sufficient funds to fully prefund the increase.

Supplemental increases to the 1.50% cost-of-living adjustment will require prefunding, appropriation and legislative action by the Kentucky General Assembly.

Additionally, legislation provides that a pension benefit shall be increased, if necessary, so that it equals an amount calculated by using a 1.5125% benefit rate and the current 60-month average earnings of the position held by the member at the time of retirement, subject to a 4.0% COLA annually.

As an additional retirement benefit, the Judicial Defined Benefit Plan will pay a percentage, based on years of service, of the members' hospital and medical insurance coverage for the retirees and their qualified dependents.

As of January 1, 2014, participation in the Judicial Defined Benefit Plan is closed to new members. All new members of the Judicial Plan participate in the Judicial Hybrid Cash Balance Plan. However, membership in the Judicial Defined Benefit Plan is reactivated if a former participant becomes eligible again to participate in the Judicial Plan.

**Plan Description – Hybrid Cash Balance Plan**

The Judicial Hybrid Cash Balance Plan provides retirement benefits to a vested member electing to participate in the Judicial Plan after January 1, 2014, and to their beneficiaries, based on the member's accumulated cash balance account. The cash balance account consists of the member's personal contributions, the employer's current pay credit of 4.00% and applicable interest. The retiree has certain distribution options, including lifetime annuity, lump sum and optional survivor benefit payments. Vesting is achieved either (a) at age 65 with accumulation of five years of active service credit in the Judicial Hybrid Cash Balance Plan and any other state-supported retirement system of the Commonwealth; or (b) at least age 57 and the member's accumulated active service credit in the Judicial Hybrid Cash Balance Plan and other state-supported retirement system of the Commonwealth plus his/her age is at least 87.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 2 – Plan Description and Contribution Information (Continued)**

A non-vested member (one with less than five years of service) is entitled to a refund of his/her personal contributions, but forfeits the employer credit. A refund of the cash balance account for a member with five or more years of service includes his/her personal contributions, the employer credit, and applicable interest.

There are special statutory provisions regarding disability benefits and death benefits in the line of duty.

Any cost-of-living adjustment (pro-rated for the first year if the recipient has been retired for less than one year) will be granted providing the following statutory requirements occur:

- 1) The funding level of the Judicial Hybrid Cash Balance Plan is greater than 100% and subsequent legislation authorizes the use of any surplus actuarial assets to provide for the increase; and
- 2) The Kentucky General Assembly appropriates sufficient funds to fully prefund the increase.

As an additional retirement benefit, a recipient of a hybrid cash balance retirement allowance with at least 15 years of State service is eligible for a monthly health insurance benefit. The health insurance benefit is \$10.00 for each year of plan service. The minimum service requirement is waived for a member who is disabled in the line of duty, or for the qualified survivor of a member who is killed in the line of duty.

**Contributions – Defined Benefit Plan**

Members entering membership on or after September 1, 2008 contribute 6% of their official salary, as defined. Members who first participated on or after July 1, 1978 and prior to September 1, 2008 contribute at a rate of 5% of their official salary. Once a member has earned sufficient service credit to have accrued a benefit of 100% of final average compensation, then employee contributions shall cease. The Commonwealth made a normal contribution at the actuarially-determined rate calculated by utilizing the entry age normal method of funding, and a past service contribution equal to 1% of the unfunded past service liability and contributed interest on the unfunded past service liabilities at the actuarially-assumed interest rate of 7%, in an amount equal to 100% of the amount required by Kentucky Revised Statute (KRS) 21.525. Additionally, the Commonwealth made an appropriation to cover administrative expenses of the Judicial Defined Benefit Plan. Members may transfer qualified member and Commonwealth contributions into the Judicial Defined Benefit Plan from other state funded retirement plans.

**Contributions – Hybrid Cash Balance Plan**

Members electing to participate in the Judicial Hybrid Cash Balance Plan contribute an amount equal to 6% of official salary. Of this, 1% is to be used to fund retiree health benefits and is not refundable. For each pay period that a personal contribution is made, the Commonwealth will apply an employer credit of 4% of official salary to the member's account. On June 30 of each year, interest, in accordance with KRS 21.402, will be credited to the account. As of June 30, 2016 and 2015, approximately \$299,755 and \$99,500, respectively, of the fiduciary net position of the System relates to the Judicial Hybrid Cash Balance Plan.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 2 – Plan Description and Contribution Information (Continued)**

Kentucky Legislators Retirement Plan

Membership – Defined Benefit Plan

Total membership in the defined benefit plan of the Kentucky Legislators Retirement Plan (Legislators Defined Benefit Plan) consisted of the following at July 1, 2015, the date of the last actuarial valuation, and as of June 30, 2016:

	<u>July 1, 2015</u>	<u>June 30, 2016</u>
Retirees and beneficiaries receiving benefits	194	200
Terminated plan members-vested	45	42
Active plan members	104	101
Total	<u>343</u>	<u>343</u>
Number of participating employers	<u>1</u>	<u>1</u>

Membership – Hybrid Cash Balance Plan

Membership in the hybrid cash balance plan of the Kentucky Legislators Retirement Plan (Legislators Hybrid Cash Balance Plan) consisted of 11 individuals at June 30, 2015, and 14 individuals at June 30, 2016.

Plan Description – Defined Benefit Plan

The Legislators Defined Benefit Plan is a single-employer defined benefit plan that provides retirement benefits and medical insurance premium supplements, and covers the members of the Kentucky General Assembly.

The Legislators Defined Benefit Plan provides retirement, disability, and death benefits to plan members and their beneficiaries. Prior to June 30, 2009, cost-of-living adjustments (COLA), keyed to the Consumer Price Index, were provided on July 1 of each year. Commencing in 2009, the COLA on July 1 of each year is 1.50%. The COLA created in 2009 was suspended by legislative action in 2012, and no COLA's have since been granted. By legislative action in 2013, the statute was amended to provide that each July 1, a recipient of a monthly pension benefit from the Legislators Defined Benefit Plan shall receive a 1.50% cost-of-living adjustment (pro-rated for the first year, if the recipient has been retired for less than one year) if:

- 1) The funding level of the Legislators Defined Benefit Plan is greater than 100% and subsequent legislation authorizes the use of any surplus actuarial assets to provide for the increase; and
- 2) The Kentucky General Assembly appropriates sufficient funds to fully prefund the increase.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 2 – Plan Description and Contribution Information (Continued)**

Supplemental increases to the 1.50% cost-of-living adjustment will require prefunding, appropriation and legislative action by the Kentucky General Assembly.

Additionally, legislation provides that a pension benefit shall be increased, if necessary, so that it equals an amount calculated by using a 1.5125% benefit rate and the current 60-month average earnings of the position held by the member at the time of retirement, subject to a 4.0% COLA annually.

As an additional retirement benefit, the Legislators Defined Benefit Plan will pay a percentage, based on years of service, of the members' hospital and medical insurance coverage for the retirees and their qualified dependents.

As of January 1, 2014, participation in the Legislators Defined Benefit Plan is closed to new members. All new members of the Legislators Plan participate in the Legislators Hybrid Cash Balance Plan. However, membership in the Legislators Defined Benefit Plan is reactivated if a former participant becomes eligible again to participate in the Legislators Plan.

**Plan Description – Hybrid Cash Balance Plan**

The Legislators Hybrid Cash Balance Plan provides retirement benefits to a vested member electing to participate in the Legislators Plan after January 1, 2014, and to their beneficiaries, based on the member's accumulated cash balance account. The cash balance account consists of the member's personal contributions, the employer's current pay credit of 4.00% and applicable interest. The retiree has certain distribution options, including lifetime annuity, lump sum and optional survivor benefit payments. Vesting is achieved either (a) at age 65 with accumulation of five years of active service credit in the Legislators Hybrid Cash Balance Plan and any other state-supported retirement system of the Commonwealth; or (b) at least age 57 and the member's accumulated active service credit in the Legislators Hybrid Cash Balance Plan and other state-supported retirement system of the Commonwealth plus his/her age is at least 87.

A non-vested member (one with less than five years of service) is entitled to a refund of his/her personal contributions, but forfeits the employer credit. A refund of the cash balance account for a member with five or more years of service includes his/her personal contributions, the employer credit, and applicable interest.

There are special statutory provisions regarding disability benefits and death benefits in the line of duty.

Any cost-of-living adjustment (pro-rated for the first year if the recipient has been retired for less than one year) will be granted providing the following statutory requirements occur:

- 1) The funding level of the Legislators Hybrid Cash Balance Plan is greater than 100% and subsequent legislation authorizes the use of any surplus actuarial assets to provide for the increase; and
- 2) The Kentucky General Assembly appropriates sufficient funds to fully prefund the increase.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 2 – Plan Description and Contribution Information (Continued)**

As an additional retirement benefit, a recipient of a hybrid cash balance retirement allowance with at least 15 years of State service is eligible for a monthly health insurance benefit. The health insurance benefit is \$10.00 for each year of plan service. The minimum service requirement is waived for a member who is disabled in the line of duty, or for the qualified survivor of a member who is killed in the line of duty.

**Contributions – Defined Benefit Plan**

Members entering membership on or after September 1, 2008 must contribute 6% of their “creditable compensation,” as defined. Members who first participated on or after July 1, 1978 and prior to September 1, 2008 contribute at a rate of 5% of their “creditable compensation.” Once a member has earned sufficient service credit to have accrued a benefit of 100% of final average compensation, employee contributions shall cease. The Commonwealth made a normal contribution at the actuarially determined rate calculated by utilizing the entry age normal method of funding, and a past service contribution equal to 1% of the unfunded past service liability and contributed interest on the unfunded past service liabilities at the actuarially assumed interest rate of 7%, in an amount equal to 100% of the amount required by KRS 21.525. Additionally, the Commonwealth made an appropriation to cover administrative expenses of the Legislators Defined Benefit Plan. Members may transfer qualified member and Commonwealth contributions into the Legislators Defined Benefit Plan from other state funded retirement plans.

**Contributions – Hybrid Cash Balance Plan**

Members electing to participate in the Legislators Hybrid Cash Balance Plan contribute an amount equal to 6% of official salary. Of this, 1% is to be used to fund retiree health benefits and is not refundable. For each pay period that a personal contribution is made, the Commonwealth will apply an employer credit of 4% of official salary to the member’s account. On June 30 of each year, interest, in accordance with KRS 21.402 will be credited to the account. As of June 30, 2016 and 2015, approximately \$75,963 and \$24,000, respectively, of the fiduciary net position of the System relates to the Legislators Hybrid Cash Balance Plan.

**Note 3 – Investments**

Each of the Plans has its own investment committee. The committee governing the Judicial Retirement Plan consists of the three judicial appointees and the two gubernatorial appointees to the System’s Board of Trustees. The committee governing the Legislators Retirement Plan consists of the three legislative appointees and the two gubernatorial appointees to the System’s Board of Trustees. All investment decisions conform to the parameters established by KRS 386 and the System’s Investment Policy Statement. Each retirement plan has two tiers, a Defined Benefit Plan tier and a Hybrid Cash Balance Plan tier. Funds for each retirement plan and each tier are maintained separately. The parameters applicable to the Defined Benefit investments for both retirement plans are:

- a. Equities may be represented in the portfolio up to 70% of the fund’s market value (with a fluctuation tolerance of 10%).

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 3 – Investments (Continued)**

- b. Fixed Income securities and/or cash and equivalents may be represented up to 30% of the fund's market value (with a fluctuation tolerance of 10%).
- c. If an allocation exceeds its targeted range for six consecutive weeks, the investment committee for each retirement fund will be notified and will make an affirmative decision whether, given the current market indicators and relative risk profile of the portfolio at that time, an adjustment to lessen the fund's applicable percentage exposure is immediately required.
- d. Investment in common stocks shall be from those stocks that meet the statutory standards for investment in trust funds, except that not more than 50% of the total equity portfolio of each fund may be invested in common stocks with a dividend payment history of less than five years.
- e. Investment in an individual equity security shall not exceed 5% of the fund's then current market value of the equity portfolio. At a time when the security's value reaches 8% of the fund's market value of the equity portfolio, the manager shall immediately notify the appropriate investment committee so that the investment committee may determine a course of action.
- f. Equity investment in a particular industry shall not exceed 25% of the fund's market value of the equity portfolio.
- g. No issues (with the exception of those of the U.S. Government and its Agencies) may be purchased with more than 15 years duration.
- h. Investments in securities of the U.S. Government and its Agencies may be purchased with a maturity of up to 30 years, but the average maturity of those securities in each fund shall not exceed ten years.
- i. Investments in securities at time of purchase of a single issuer (with the exception of U.S. Government and its Agencies) of each fund must not exceed 5% of the fund's market value of the Fixed Income portfolio.
- j. Only corporate debt issues that meet or exceed a credit rating of BBB from Standard & Poor's and/or a BAA rating from Moody's may be purchased.
- k. Preferred stocks must be rated A or better by Moody's and/or Standard & Poor's at the time of purchase.
- l. Investment in bonds will be limited to those eligible for purchase by national banks.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 3 – Investments (Continued)**

- m. Bond maturities will be reasonably spaced with due consideration given to call provisions.
- n. The fund manager is prohibited from investing in private placements, from speculating in fixed income or interest rate futures, and from arbitrage or any other specialized investments.
- o. The fund manager may invest in commercial paper, repurchase agreements, and Treasury Bills to provide income, liquidity for expense payments and preservation of the funds' principal value. Commercial paper assets must be rated at least A-2 or P-2 by Standard & Poor's and Moody's, respectively. The fund manager may not invest for a fund more than 10% of the fund's market value in the obligations of a single government agency, except obligations of the U.S. Government and its agencies which are not restricted. Corporate cash equivalent investments shall be restricted to not more than 7% per issuer.

The parameters applicable to the Hybrid Cash Balance investments for both retirement plans are:

- a. Equities may be represented in the portfolio up to 70% of the fund's market value (with a fluctuation tolerance of 5%).
- b. Fixed Income securities may be represented up to 30% of the fund's market value (with a fluctuation tolerance of 5%).
- c. Equities shall be invested in the Vanguard 500 Index VFINX.
- d. Fixed Income assets shall be invested in the Barclays iShares Intermediate Credit Bond CIU.
- e. Pending investments identified above, the fund manager may invest in commercial paper, repurchase agreements, and Treasury Bills to provide income, liquidity for expense payments and preservation of the funds' principal value. Commercial paper assets must be rated at least A-2 or P-2 by Standard & Poor's and Moody's, respectively. Qualified cash or cash equivalents are limited to 5% of the market value.

**Rate of Return**

For the year ended June 30, 2016, the annual money-weighted rate of return on pension plan investments, net of investment expense, for the Judicial Plan and the Legislators Plan, was 3.2% and 3.6%, respectively. For the year ended June 30, 2015, the annual money-weighted rate of return on pension plan investments, net of investment expense, for the Judicial Plan and the Legislators Plan, was 10.2% and 10.1%, respectively. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 3 – Investments (Continued)**

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligations to the holder of the investment. More specifically, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

All investments held by the System are insured or registered and held by the System or by its agent in the System's name.

The credit risk disclosures for the municipal securities, foreign governmental securities and corporate notes within the Judicial Plan are as follows at June 30:

	S&P Quality Rating	2016	2015
Municipal securities	AA+	\$ 2,687,675	\$ 2,684,125
	A	583,065	952,749
		<u>\$ 3,270,740</u>	<u>\$ 3,636,874</u>
Foreign governmental securities	A+	\$ 2,721,875	\$ 2,731,350
		<u>\$ 2,721,875</u>	<u>\$ 2,731,350</u>
Corporate Notes	AAA	\$ 2,722,125	\$ 2,731,875
	AA+	4,224,547	4,646,578
	AA	7,050,860	6,869,010
	AA-	15,490,078	16,921,018
	A+	7,372,648	6,786,050
	A	13,056,644	9,642,164
	A-	5,419,000	6,274,480
	BBB+	4,283,540	
Not Rated*	83,890		
		<u>\$ 59,703,332</u>	<u>\$ 53,871,175</u>

\* Investment in Ishares Intermediate Credit Bond ETF for the Judicial Hybrid Cash Balance Plan is a combination of securities and thus a single rating is not assigned.



**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 3 – Investments (Continued)**

The credit risk disclosures for the municipal securities, foreign governmental securities, and corporate notes within the Legislators Plan are as follows at June 30:

	S&P Quality Rating	2016	2015
		<u>                    </u>	<u>                    </u>
Municipal securities	AA+	\$ 430,028	\$ 429,460
		<u>\$ 430,028</u>	<u>\$ 429,460</u>
Foreign governmental securities	A+	\$ 653,250	\$ 655,524
		<u>\$ 653,250</u>	<u>\$ 655,524</u>
Corporate Notes	AAA	\$ 816,637	\$ 819,562
	AA+	2,231,779	1,470,257
	AA	1,640,002	1,614,645
	AA-	4,543,616	5,030,873
	A+	2,944,680	3,090,764
	A	5,360,656	4,225,548
	A-	763,896	1,931,805
	BBB+	2,467,833	506,740
	Not Rated*	20,694	
		<u>\$ 20,789,793</u>	<u>\$ 18,690,194</u>

\* Investment in Ishares Intermediate Credit Bond ETF for the Legislators Hybrid Cash Balance Plan is a combination of securities and thus a single rating is not assigned.

**Concentration of Credit Risk**

Investments exceeded more than 5% of Plan fiduciary net position as follows: At June 30, 2016, Home Depot at 5.8% in the Judicial Plan and Home Depot at 5.7% in the Legislators Plan. At June 30, 2015, CVS Health Corp. at 5.2%, Walt Disney at 5.1% and Home Depot at 5.5% in the Judicial Plan and CVS Health Corp. at 5.2%, Walt Disney at 5.2%, and Home Depot at 5.5% in the Legislators Plan.

**Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. The System manages its exposure to declines in fair value by purchasing a diverse combination of equity securities and debt securities with varying maturities.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
NOTES TO THE FINANCIAL STATEMENTS**

**June 30, 2016**

**(Continued)**

**Note 3 – Investments (Continued)**

The debt securities, and related maturities, within the Judicial Plan are as follows at June 30, 2016:

	Amount	Less Than One Year	1 - 5 Years	6 - 10 Years
Governmental securities	\$23,515,414	\$1,013,460	\$22,501,954	\$
Foreign governmental securities	2,721,875		2,721,875	
Corporate Notes	59,703,332		43,583,872	16,119,460
Total	<u>\$85,940,621</u>	<u>\$1,013,460</u>	<u>\$68,807,701</u>	<u>\$16,119,460</u>

The debt securities, and related maturities, within the Judicial Plan are as follows at June 30, 2015:

	Amount	Less Than One Year	1 - 5 Years	6 - 10 Years
Governmental securities	\$27,822,533	\$3,655,690	\$19,207,805	\$ 4,959,038
Foreign governmental securities	2,731,350		2,731,350	
Corporate Notes	53,871,175	4,472,978	29,240,672	20,157,525
Total	<u>\$84,425,058</u>	<u>\$8,128,668</u>	<u>\$51,179,827</u>	<u>\$25,116,563</u>

The debt securities, and related maturities, within the Legislators Plan are as follows at June 30, 2016:

	Amount	Less Than One Year	1 - 5 Years	6 - 10 Years
Governmental securities	\$4,642,854	\$506,730	\$4,136,124	\$
Foreign governmental securities	653,250		653,250	
Corporate Notes	20,789,793		15,242,275	5,547,519
Total	<u>\$26,085,897</u>	<u>\$506,730</u>	<u>\$20,031,649</u>	<u>\$5,547,519</u>

The debt securities, and related maturities, within the Legislators Plan are as follows at June 30, 2015:

	Amount	Less Than One Year	1 - 5 Years	6 - 10 Years
Governmental securities	\$5,465,349	\$523,410	\$3,995,005	\$ 946,934
Foreign governmental securities	655,524		655,524	
Corporate Notes	18,690,194	509,925	10,658,841	7,521,428
Total	<u>\$24,811,067</u>	<u>\$1,033,335</u>	<u>\$15,309,370</u>	<u>\$8,468,362</u>

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 3 – Investments (Continued)**

Foreign Currency Risk

Foreign currency risk is defined as the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. As of June 30, 2015 and June 30, 2016, neither the Judicial Plan nor the Legislators Plan held securities subject to foreign currency risk.

Cash and Investments Held by State Treasury

At June 30, 2016 and 2015, the System's share of deposits in the Commonwealth's general depository (State investment pool) totaled \$302,779 and \$240,549, respectively. The Commonwealth's CAFR for the year ended June 30, 2016 should be referred to for required disclosures.

Custodian

Effective August 2011, State Street Bank and Trust Company became custodian of the Defined Benefit Plans' investments. Effective April 2015, BMO Harris Bank, N.A. became custodian of the Hybrid Cash Balance Plans' investments.

**Note 4 – Fair Value Measurement**

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy are described as follows:

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the entity has the ability to access.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 4 – Fair Value Measurement (Continued)**

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2016.

- U.S. government securities: Valued using pricing models maximizing the use of observable inputs for similar securities.
- Common stock: Valued at the closing price reported on the New York Stock Exchange.
- Corporate bonds: Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for identical or similar bonds, the bond is valued under a discounted cash flows approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks or a broker quote if available.
- Foreign government securities: Valued using pricing from Interactive Data which offers daily evaluations and related data for international fixed income securities with embedded equity options including convertible and exchangeable bonds.
- State Investment Pool-Investments and Cash Equivalents: Valued using the three levels defined above.

The following table sets forth by level, within the hierarchy, the System's assets and liabilities measured at fair value on a recurring basis as of June 30, 2016 are as follows:

**Judicial Retirement Plan**  
**Assets at Fair Value as of June 30, 2016**

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
State Investment Pool-Investments and Cash Equivalents	\$ 185,309	\$	\$ 12,143	\$ 197,452
Common Stock	250,336,193			250,336,193
Corporate Notes and Governmental Securities	83,890	85,856,731		85,940,621
Total assets at fair value	<u>\$ 250,605,392</u>	<u>\$ 85,856,731</u>	<u>\$ 12,143</u>	<u>\$ 336,474,266</u>

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 4 – Fair Value Measurement (Continued)**

Legislators Retirement Plan  
Assets at Fair Value as of June 30, 2016

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
State Investment Pool-Investments and Cash Equivalents	\$ 25,149	\$ 92,321	\$ 3,400	\$ 120,870
Common Stock	73,244,244			73,244,244
Corporate Notes and Governmental Securities	20,694	26,065,203		26,085,897
Total assets at fair value	<u>\$ 73,290,087</u>	<u>\$ 26,157,524</u>	<u>\$ 3,400</u>	<u>\$ 99,451,011</u>

The System's policy is to recognize transfers between levels as of the actual date of the event or change in circumstances. There were no transfers between levels during 2016.

The System holds investments which are exposed to various risks such as interest rate, market, and credit. Due to the level of risk associated with these securities and the level of uncertainty related to changes in the value, it is at least reasonably possible that changes in the various risk factors will occur in the near term that could materially affect the amounts reported in the accompanying financial statements.

**Note 5 – Net Pension Liability**

**Judicial Defined Benefit Plan**

The components of the net pension liability of the Judicial Defined Benefit Plan were as follows:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Total pension liability	\$376,509,460	\$371,204,416
Pension plan fiduciary net position	(267,190,593)	(264,466,119)
Plan's net pension liability	<u>\$109,318,867</u>	<u>\$106,738,297</u>

The Plan's fiduciary net position as a percentage of total pension liability is 70.97% in 2016 and 71.25% in 2015.

The following are the actuarial methods and assumptions used to develop the above liabilities:

Valuation Date:	July 1, 2015
Actuarial Cost Method:	Entry Age Normal funding method
Amortization Method:	Interest +1% Unfunded Past Liability
Asset Valuation Method:	Market Value
Investment Return:	6.41%
Inflation:	3.00%
Projected Salary Increases:	1% for the next five years, and 3.5% thereafter

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 5 – Net Pension Liability (Continued)**

Mortality rates were based on RP-2000 Mortality Tables with white-collar adjustment with Pre and Post Commencement Rates with projected mortality improvements after year 2000 under Projection Scale AA (male and females scales).

The long-term expected rate of return on Judicial Defined Benefit Plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expenses and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the Judicial Defined Benefit Plan's target asset allocation as of June 30, 2016 (see the discussion of the Judicial Defined Benefit Plan's investment policy) are summarized in the following table:

<u>Asset Class</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic Equity	5.05%
International Equity	5.45%
Fixed Income	0.55%
Cash	-1.85%

The discount used to measure the total pension liability was 6.41%, an increase from the 6.15% discount rate used as of July 1, 2014. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at the current statutory contribution rates. Based on those assumptions, the Judicial Defined Benefit Plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members through June 30, 2049. The long-term expected rate of return on the Judicial Defined Benefit Plan's investments was applied to periods of projected benefit payments through this date, and the municipal bond rate, determined by using the 20-year municipal AA bond yield at July 1, 2015, for the periods thereafter to determine the total pension liability. The discount used to measure the total pension liability on the second basis was 7.00% for 34 years, and 3.80% thereafter. This is equivalent to an average assumed rate of return of approximately 6.41%.

The following presents the net pension liability of the Judicial Defined Benefit Plan, calculated using the discount rate of 6.41%, as well as what the Judicial Defined Benefit Plan's pension liability would be if it was calculated using a discount rate that is 1% point lower (5.41%) or 1% point higher (7.41%) than the current rate:

<u>Net Pension Liability/(Asset)</u>	<u>1% Decrease (5.41%)</u>	<u>Current Rate (6.41%)</u>	<u>1% Increase (7.41%)</u>
June 30, 2016	\$149,097,714	\$109,318,867	\$75,856,734
June 30, 2015	\$146,913,325	\$106,738,297	\$72,976,935

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 5 – Net Pension Liability (Continued)**

Judicial Hybrid Cash Balance Plan

The components of the net pension liability of the Judicial Hybrid Cash Balance Plan were as follows:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Total pension liability	\$261,651	\$84,979
Pension plan fiduciary net position	<u>(265,040)</u>	<u>(90,516)</u>
Plan's net pension asset	<u>(\$3,389)</u>	<u>(\$5,537)</u>

The Plan's fiduciary net position as a percentage of total pension liability is 101.30% in 2016 and 106.52% in 2015.

The following are the actuarial methods and assumptions used to develop the above liabilities:

Valuation Date:	July 1, 2015
Actuarial Cost Method:	Entry Age Normal funding method
Amortization Method:	Interest +1% Unfunded Past Liability
Asset Valuation Method:	Market Value
Investment Return:	4.00%
Inflation:	3.00%
Projected Salary Increases:	1% for the next five years, and 3.5% thereafter

Mortality rates were based on RP-2000 Mortality Tables with white-collar adjustment with Pre and Post Commencement Rates with projected mortality improvements after year 2000 under Projection Scale AA (male and females scales).

The discount used to measure the total pension liability was 4.00%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at the current statutory employer pay credit rates.

The following presents the net pension liability of the Judicial Hybrid Cash Balance Plan, calculated using the discount rate of 4.00%, as well as what the Judicial Hybrid Cash Balance Plan's pension liability would be if it was calculated using a discount rate that is 1% point lower (3.00%) or 1% point higher (5.00%) than the current rate:

<u>Net Pension Liability/(Asset)</u>	<u>1% Decrease (3.00%)</u>	<u>Current Rate (4.00%)</u>	<u>1% Increase (5.00%)</u>
June 30, 2016	\$13,949	(\$3,389)	(\$19,536)
June 30, 2015	\$700	(\$5,537)	(\$11,336)

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 5 – Net Pension Liability (Continued)**

Legislators Defined Benefit Plan

The components of the net pension liability of the Legislators Defined Benefit Plan were as follows:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Total pension liability	\$78,302,828	\$76,211,711
Pension plan fiduciary net position	<u>(61,832,520)</u>	<u>(60,088,193)</u>
Plan's net pension liability	<u>\$16,470,308</u>	<u>\$16,123,518</u>

The Plan's fiduciary net position as a percentage of total pension liability is 78.97% in 2016 and 78.84% in 2015.

The following are the actuarial methods and assumptions used to develop the above liabilities:

Valuation Date:	July 1, 2015
Actuarial Cost Method:	Entry Age Normal funding method
Amortization Method:	Interest +1% Unfunded Past Liability
Asset Valuation Method:	Market Value
Investment Return:	6.85%
Inflation:	3.00%
Projected Salary Increases:	1% for the next five years, and 3.5% thereafter

Mortality rates were based on RP-2000 Mortality Tables with white-collar adjustment with Pre and Post Commencement Rates with projected mortality improvements after year 2000 under Projection Scale AA (male and females scales).

The long-term expected rate of return on Legislators Defined Benefit Plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expenses and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the Legislators Defined Benefit Plan's target asset allocation as of June 30, 2016 (see the discussion of the Legislators Defined Benefit Plan's investment policy) are summarized in the following table:

<u>Asset Class</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic Equity	5.05%
International Equity	5.45%
Fixed Income	0.55%
Cash	-1.85%



**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 5 – Net Pension Liability (Continued)**

The discount used to measure the total pension liability was 6.85%, an increase from the 6.50% discount rate used as of July 1, 2014. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at the current statutory contribution rates. Based on those assumptions, the Legislators Defined Benefit Pension Plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members through June 30, 2062. The long-term expected rate of return on the Legislators Defined Benefit Pension Plan investments was applied to periods of projected benefit payments through this date, and the municipal bond rate, determined by using the 20-year municipal AA bond yield at July 1, 2015, for the periods thereafter to determine the total pension liability. The discount used to measure the total pension liability on the second basis was 7.00% for 47 years, and 3.80% thereafter. This is equivalent to an average assumed rate of return of approximately 6.85%.

The following presents the net pension liability of the Legislators Defined Benefit Plan, calculated using the discount rate of 6.85%, as well as what the Legislators Defined Benefit Plan's pension liability would be if it was calculated using a discount rate that is 1% point lower (5.85%) or 1% point higher (7.85%) than the current rate:

<u>Net Pension Liability/(Asset)</u>	<u>1% Decrease (5.85%)</u>	<u>Current Rate (6.85%)</u>	<u>1% Increase (7.85%)</u>
June 30, 2016	\$24,678,230	\$16,470,308	\$9,598,394
June 30, 2015	\$24,401,512	\$16,123,518	\$9,198,442

**Legislators Hybrid Cash Balance Plan**

The components of the net pension liability of the Legislators Hybrid Cash Balance Plan were as follows:

	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Total pension liability	\$60,250	\$21,726
Pension plan fiduciary net position	<u>(59,665)</u>	<u>(19,859)</u>
Plan's net pension liability	<u>\$ 585</u>	<u>\$1,867</u>

The Plan's fiduciary net position as a percentage of total pension liability is 99.03% in 2016 and 91.41% in 2015.

The following are the actuarial methods and assumptions used to develop the above liabilities:

Valuation Date:	July 1, 2015
Actuarial Cost Method:	Entry Age Normal funding method
Amortization Method:	Interest +1% Unfunded Past Liability
Asset Valuation Method:	Market Value
Investment Return:	4.00%
Inflation:	3.00%
Projected Salary Increases:	1% for the next five years, and 3.5% thereafter

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 5 – Net Pension Liability (Continued)**

Mortality rates were based on RP-2000 Mortality Tables with white-collar adjustment with Pre and Post Commencement Rates with projected mortality improvements after year 2000 under Projection Scale AA (male and females scales).

The discount used to measure the total pension liability was 4.00%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at the current statutory employer pay credit rates.

The following presents the net pension liability of the Legislators Hybrid Cash Balance Plan, calculated using the discount rate of 4.00%, as well as what the Legislators Hybrid Cash Balance Plan's pension liability would be if it was calculated using a discount rate that is 1% point lower (3.00%) or 1% point higher (5.00%) than the current rate:

<u>Net Pension Liability/(Asset)</u>	<u>1% Decrease (3.00%)</u>	<u>Current Rate (4.00%)</u>	<u>1% Increase (5.00%)</u>
June 30, 2016	\$4,647	\$585	(\$3,207)
June 30, 2015	\$3,544	\$1,867	\$307

**Note 6 – Funded Status and Funding Progress**

**Defined Benefit Plans**

The funded status of the Judicial Defined Benefit Plan's medical insurance benefits as of June 30, 2016, the most recent actuarial valuation date, is as follows:

<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a Percentage of Covered Payroll ((b-a)/c)</u>
\$67,725,236	\$64,684,050	\$ (3,041,186)	104.7%	\$30,009,326	-10.1%

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 6 – Funded Status and Funding Progress (Continued)**

The funded status of the Legislators Defined Benefit Plan's medical insurance benefits as of June 30, 2016, the most recent actuarial valuation date, is as follows:

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
\$36,413,147	\$28,608,061	\$ (7,805,086)	127.3%	\$4,467,419	-174.7%

The following are the actuarial methods and assumptions used to develop the above liabilities:

Valuation date:	July 1, 2015
Actuarial cost method:	Entry Age Normal funding method
Amortization Method:	Interest + 1% Unfunded Past Liability
Asset valuation method:	Market Value
Investment return:	Judicial Defined Benefit Plan: 6.41%, Legislators Defined Benefit Plan: 6.85%
Inflation:	3.00%
Projected salary increases:	1% for the next 5 years, and 3.5% thereafter

Projected medical premium increases:

Year 1	11%
Year 2	10%
Year 3	9%
Year 4	8%
Year 5	7%
Year 6	6%
Year 7+	5%

Split of medical coverage among retirees:

	Percent of Retirees		Percent with Spouse Coverage
	Judicial	Legislators	
<u>Pre-Medicare</u>			
Family	39%	32%	Not Applicable
Single	16%	21%	Not Applicable
Parent Plus	29%	32%	Not Applicable
Member and Spouse	16%	16%	Not Applicable
<u>Medicare coverage</u>			
Medicare Advantage PPO	100%	100%	75%

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
NOTES TO THE FINANCIAL STATEMENTS**

**June 30, 2016**

**(Continued)**

**Note 6 – Funded Status and Funding Progress (Continued)**

The Schedules of Funding Progress – Medical Insurance, presented as required supplementary information following the notes to the financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the Actuarial Accrued Liabilities for benefits.

The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations.

**Hybrid Cash Balance Plans**

The funded status of the Judicial Hybrid Cash Balance Plan's medical insurance benefits as of June 30, 2016, the most recent actuarial valuation date, is as follows:

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
\$31,282	\$25,319	\$ (5,963)	123.6%	\$1,935,756	-0.3%

The funded status of the Legislators Hybrid Cash Balance Plan's medical insurance benefits as of June 30, 2016, the most recent actuarial valuation date, is as follows:

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
\$15,128	\$18,181	\$3,053	83.2%	\$419,012	0.7%

The following are the actuarial methods and assumptions used to develop the above liabilities:

Valuation date:	July 1, 2015
Actuarial cost method:	Entry Age Normal funding method
Amortization Method:	Interest + 1% Unfunded Past Liability
Asset valuation method:	Market Value
Investment return:	4.00%
Inflation:	3.00%
Projected salary increases:	1% for the next 5 years, and 3.5% thereafter

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 6 – Funded Status and Funding Progress (Continued)**

Projected medical premium increases:

Year 1	11%
Year 2	10%
Year 3	9%
Year 4	8%
Year 5	7%
Year 6	6%
Year 7+	5%

The Schedules of Funding Progress – Medical Insurance, presented as required supplementary information following the notes to the financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the Actuarial Accrued Liabilities for benefits.

The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations.

**Note 7 – Risk Management**

Claims against the Board of Trustees of the System, or any of its staff, as a result of actual or alleged breach of fiduciary duty are insured with a commercial insurance policy. Coverage provided is limited to \$10,000,000.

Claims for job-related illnesses or injuries are insured by the Commonwealth's self-insured workers' compensation program. Payments approved by the program are not subject to maximum limitations.

**Note 8 – Income Tax Status**

The Judicial Plan and Legislators Plan each received from the Internal Revenue Service favorable determination letters dated July 9, 2009, which state that the Plans constitute qualified plans under Section 401(a) of the Internal Revenue Code.

The System believes that the Plans are currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Any compensation deferred under either Plan, as well as income attributable to the deferrals, is not includable in federal and state taxable income until actually paid or otherwise made available to the participant or their named beneficiary.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2016**  
**(Continued)**

**Note 9 – Recent GASB Pronouncements**

The following GASB statements were effective beginning in FY16 and the System has implemented the statements, as applicable:

GASB Statement No. 72, *Fair Value Measurement and Application*, addresses accounting and financial reporting issues related to fair value measurements. This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. In addition, the statement establishes a hierarchy of inputs to valuation techniques used to measure fair value.

GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, establishes requirements for defined benefit and defined contribution plans not within the scope of GASB 68. It also amends certain provisions of Statement No. 67, *Financial Reporting for Pension Plans*, related to the required supplementary information.

Management has not currently determined what, if any, effects implementation of the following statements may have on the financial statements:

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* improves financial reporting by state and local governmental other postemployment benefit (OPEB) plans. The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by the OPEB plans that are within its scope. This statement is effective for financial statements for fiscal years beginning after June 15, 2016.

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, improves financial reporting for employers by establishing new accounting and financial reporting requirements for OPEB plans. This statement is effective for fiscal years beginning after June 15, 2016.

**REQUIRED SUPPLEMENTARY INFORMATION**





**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**

**REQUIRED SUPPLEMENTARY INFORMATION**

**For the Year Ended June 30, 2016**

**Schedule of Changes in Net Pension Liability and Related Ratios**

Kentucky Judicial Retirement Plan

	<u>2016</u>	<u>2015</u>	<u>2014</u>
<u>Total pension liability</u>			
Service cost	\$ 4,966,600	\$ 5,000,000	\$ 5,000,000
Interest	23,410,100	22,100,000	21,900,000
Changes in benefit terms		85,000	
Differences between expected and actual experience		4,400,000	
Changes in assumptions		(4,400,000)	29,100,000
Benefit payments/refunds of member contributions	(22,900,000)	(22,200,000)	(21,800,000)
Net change in total pension liability	<u>5,476,700</u>	<u>4,985,000</u>	<u>34,200,000</u>
Total pension liability - beginning	<u>371,285,000</u>	<u>366,300,000</u>	<u>332,100,000</u>
Total pension liability - ending	<u>\$ 376,761,700</u>	<u>\$ 371,285,000</u>	<u>\$ 366,300,000</u>
 <u>Pension plan fiduciary net position</u>			
Contributions - employer	\$ 15,471,300	\$ 15,442,300	\$ 12,400,000
Contributions - member	1,799,100	1,947,900	2,800,000
Net investment income	8,704,100	25,300,300	32,900,000
Benefit payments/refunds of member contributions	(22,900,000)	(22,200,000)	(21,800,000)
Administrative expenses	(300,000)	(200,000)	(200,000)
Other	100,000	400,000	400,000
Net change in plan fiduciary net position	<u>2,874,500</u>	<u>20,690,500</u>	<u>26,500,000</u>
Pension plan fiduciary net position - beginning	<u>264,590,500</u>	<u>243,900,000</u>	<u>217,400,000</u>
Pension plan fiduciary net position - ending	<u>\$ 267,465,000</u>	<u>\$ 264,590,500</u>	<u>\$ 243,900,000</u>
 Net pension liability - ending	<u>\$ 109,296,700</u>	<u>\$ 106,694,500</u>	<u>\$ 122,400,000</u>
 Pension plan fiduciary net position as a % of the total pension liability	71.0%	71.3%	66.6%
 Covered-employee payroll	\$ 31,936,000	\$ 31,936,000	\$ 32,900,000
 Net Pension Liability as a % of covered employee payroll	342.2%	334.1%	372.0%

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
REQUIRED SUPPLEMENTARY INFORMATION  
For the Year Ended June 30, 2016  
(Continued)**

**Schedule of Changes in Net Pension Liability and Related Ratios**

Kentucky Legislators Retirement Plan

	2016	2015	2014
<u>Total pension liability</u>			
Service cost	\$ 936,200	\$ 1,000,000	\$ 1,000,000
Interest	5,202,400	5,100,000	4,900,000
Changes in benefit terms		21,700	
Differences between expected and actual experience		(3,400,000)	
Changes in assumptions		(1,500,000)	3,700,000
Benefit payments/refunds of member contributions	(4,000,000)	(3,700,000)	(3,500,000)
Net change in total pension liability	2,138,600	(2,478,300)	6,100,000
Total pension liability - beginning	76,221,700	78,700,000	72,600,000
Total pension liability - ending	<u>\$ 78,360,300</u>	<u>\$ 76,221,700</u>	<u>\$ 78,700,000</u>
<u>Pension plan fiduciary net position</u>			
Contributions - employer	\$ 3,414,500	\$ 3,408,800	\$ 1,800,000
Contributions - member	324,600	211,000	200,000
Net investment income	2,000,700	5,600,100	7,900,000
Benefit payments/refunds of member contributions	(4,000,000)	(3,700,000)	(3,500,000)
Administrative expenses	(200,000)	(100,000)	(100,000)
Other	200,000	100,000	100,000
Net change in plan fiduciary net position	1,739,800	5,519,900	6,400,000
Pension plan fiduciary net position - beginning	60,119,900	54,600,000	48,200,000
Pension plan fiduciary net position - ending	<u>\$ 61,859,700</u>	<u>\$ 60,119,900</u>	<u>\$ 54,600,000</u>
Net pension liability - ending	<u>\$ 16,500,600</u>	<u>\$ 16,101,800</u>	<u>\$ 24,100,000</u>
Pension plan fiduciary net position as a % of the total pension liability	78.9%	78.9%	69.4%
Covered-employee payroll	\$ 4,919,000	\$ 4,919,000	\$ 5,000,000
Net Pension Liability as a % of covered employee payroll	335.4%	327.3%	482.0%

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
REQUIRED SUPPLEMENTARY INFORMATION  
For the Year Ended June 30, 2016  
(Continued)**

**Schedule of Contributions  
Last 10 Fiscal Years**

Kentucky Judicial Retirement Plan

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Actuarially determined contribution	\$ 15,171,300	\$ 15,142,300	\$ 15,219,761	\$ 15,219,761	\$ 10,302,430	\$ 10,302,430	\$ 4,511,980	\$ 4,511,980	\$ 2,374,894	\$ 2,835,242
Contributions in relation to the actuarially determined contribution	15,171,300	15,142,300	10,804,715	10,398,987	4,945,968	4,533,804	4,469,535	4,469,535	2,374,859	2,788,060
Contribution deficiency			(4,415,046)	(4,820,774)	(5,356,462)	(5,768,626)	(42,445)	(42,445)	(35)	(47,182)
Covered-employee payroll	31,936,000	31,936,000	32,930,076	32,930,076	33,175,215	33,175,215	29,886,624	29,886,624	31,224,444	31,941,180
Contributions as a percentage of covered-employee payroll	48%	47%	33%	32%	15%	14%	15%	15%	8%	9%

**Notes to Schedule:**

Valuation Date: July 1, 2015

**Methods and assumptions used to determine contributions:**

Actuarial Cost Method: Entry Age Normal funding method. Prior to July 1, 2013, the actuarial accrued liability was calculated using the projected unit credit cost method.

Amortization Method: Interest + 1% Unfunded Past Liability

Asset Valuation Method: Market Value

Investment Return: Defined Benefit Tier: 6.41%. For July 1, 2014, an investment return of 6.15% was used. Prior to July 1, 2014, an investment return of 7% was used. Prior to July 1, 2009, an investment return of 7.5% was used. Hybrid Cash Balance Tier: 4.00%.

Inflation: 3.00%

Projected Salary Increases: 1% for the next five years, and 3.5% thereafter. Prior to July 1, 2013, the future salary increase assumption was 1% for the next year, 1% the following year and 3.5% thereafter. Prior to July 1, 2011, the future salary increase assumption was 1% for the next year, 2% the following year, and 4% thereafter.

Mortality: RP-2000 Mortality Tables with white-collar adjustment with Pre and Post Commencement Rates with projected mortality improvements after year 2000 under Projection Scale AA (male and female scales). Prior to July 1, 2015, mortality rates were based on IRS 2008 Mortality Tables without collar adjustment with Pre and Post Commencement Rates with projected mortality improvements after year 2000 under Projection Scale AA (male and female scales). Prior to July 1, 2011, RP-2000 Mortality Table projected 2009 without collar adjustment for male and female lives was used.

Note: Effective for the year ended June 30, 2008, medical insurance employer contributions have been segregated from defined benefit contributions.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
REQUIRED SUPPLEMENTARY INFORMATION  
For the Year Ended June 30, 2016  
(Continued)**

**Schedule of Contributions  
Last 10 Fiscal Years**

Kentucky Legislators Retirement Plan

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Actuarially determined contribution	\$ 3,414,500	\$ 3,408,800	\$ 3,214,854	\$ 3,214,854	\$ 2,140,019	\$ 2,140,019	\$ 319,820	\$ 319,820	\$ 428,323	\$ 713,799
Contributions in relation to the actuarially determined contribution	3,414,500	3,408,800	1,824,956	1,696,000	1,027,200	941,600	319,838	319,838	428,324	748,491
Contribution excess (deficiency)			(1,389,898)	(1,518,854)	(1,112,819)	(1,198,419)	18	18	1	34,692
Covered-employee payroll	4,919,000	4,919,000	4,987,823	4,987,823	5,192,619	5,192,619	4,916,770	4,916,770	4,755,214	4,763,785
Contributions as a percentage of covered-employee payroll	69%	69%	37%	34%	20%	18%	7%	7%	9%	16%

**Notes to Schedule:**

Valuation Date: July 1, 2015

**Methods and assumptions used to determine contributions:**

Actuarial Cost Method: Entry Age Normal funding method. Prior to July 1, 2013, the actuarial accrued liability was calculated using the projected unit credit cost method.

Amortization Method: Interest + 1% Unfunded Past Liability

Asset Valuation Method: Market Value

Investment Return: Defined Benefit Tier: 6.85%. For July 1, 2014, an investment return of 6.50% was used. Prior to July 1, 2014, an investment return of 7% was used. Prior to July 1, 2009, an investment return of 7.5% was used. Hybrid Cash Balance Tier: 4.00%

Inflation: 3.00%

Projected Salary Increases: 1% for the next five years, and 3.5% thereafter. Prior to July 1, 2013, the future salary increase assumption was 1% for the next year, 1% the following year and 3.5% thereafter. Prior to July 1, 2011, the future salary increase assumption was 1% for the next year, 2% the following year, and 4% thereafter.

Mortality: RP-2000 Mortality Tables with white-collar adjustment with Pre and Post Commencement Rates with projected mortality improvements after year 2000 under Projection Scale AA (male and female scales). Prior to July 1, 2015, mortality rates were based on IRS 2008 Mortality Tables without collar adjustment with Pre and Post Commencement Rates with projected mortality improvements after year 2000 under Projection Scale AA (male and female scales). Prior to July 1, 2011, RP-2000 Mortality Table projected 2009 without collar adjustment for male and female lives was used.

Note: Effective for the year ended June 30, 2008, medical insurance employer contributions have been segregated from defined benefit contributions.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
 REQUIRED SUPPLEMENTARY INFORMATION  
 For the Year Ended June 30, 2016  
 (Continued)**

**Schedule of Investment Returns**

Kentucky Judicial Retirement Plan

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Annual money-weighted rate of return, net of investment expense	3.2%	10.2%	15.0%

Kentucky Legislators Retirement Plan

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Annual money-weighted rate of return, net of investment expense	3.6%	10.1%	16.7%

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM  
REQUIRED SUPPLEMENTARY INFORMATION  
For the Year Ended June 30, 2016  
(Continued)**

**Schedules of Funding Progress-Medical Insurance**

Kentucky Judicial Retirement Plan

Actuarial Valuation Date	Actuarial Valuation of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
7/1/2007	\$ 42,990,926	\$ 44,137,011	\$ 1,146,085	97.4%	\$ 31,941,180	3.6%
7/1/2008	44,347,577	47,851,882	3,504,305	92.7%	31,224,444	11.2%
7/1/2009	43,816,525	39,816,215	(4,000,310)	110.0%	29,886,624	-13.4%
7/1/2010	43,186,642	41,831,779	(1,354,863)	103.2%	29,886,624	-4.5%
7/1/2011	41,791,088	43,643,278	1,852,190	95.8%	33,175,215	5.6%
7/1/2012	43,466,197	45,474,043	2,007,846	95.6%	33,175,215	6.1%
7/1/2013	46,552,166	53,732,181	7,180,015	86.6%	32,930,076	21.8%
7/1/2014	53,374,356	56,161,700	2,787,344	95.0%	32,930,076	8.5%
7/1/2015	61,057,506	61,204,042	146,536	99.8%	31,945,082	0.5%
7/1/2016	67,756,518	64,709,369	(3,047,149)	104.7%	31,945,082	-9.5%

Kentucky Legislators Retirement Plan

Actuarial Valuation Date	Actuarial Valuation of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
7/1/2007	\$ 24,289,368	\$ 22,489,737	\$ (1,799,631)	108.0%	\$ 4,763,785	-37.8%
7/1/2008	25,117,103	23,668,943	(1,448,160)	106.1%	4,755,214	-30.5%
7/1/2009	24,413,467	18,481,365	(5,932,102)	132.1%	4,916,770	-120.7%
7/1/2010	23,908,481	19,434,535	(4,473,946)	123.0%	4,916,770	-91.0%
7/1/2011	23,337,392	20,533,088	(2,804,304)	113.7%	5,192,619	-54.0%
7/1/2012	24,238,386	21,582,890	(2,655,496)	112.3%	5,192,619	-51.1%
7/1/2013	25,907,629	23,363,734	(2,543,895)	110.9%	4,987,823	-51.0%
7/1/2014	29,405,073	24,525,907	(4,879,166)	119.9%	4,987,823	-97.8%
7/1/2015	33,199,566	26,963,461	(6,236,105)	123.1%	4,886,431	-127.6%
7/1/2016	36,428,275	28,626,242	(7,802,033)	127.3%	4,886,431	-159.7%

\*Effective July 1, 2013, the actuarial accrued liability is calculated using the entry age normal funding method. Prior to July 1, 2013, the actuarial accrued liability was calculated using the projected unit credit cost method.

**KENTUCKY JUDICIAL FORM RETIREMENT SYSTEM**  
**REQUIRED SUPPLEMENTARY INFORMATION**  
**For the Year Ended June 30, 2016**  
**(Continued)**

**Schedule of Employer Contributions-Medical Insurance**

Kentucky Judicial Retirement Plan

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Annual Contribution</u>	<u>Percentage Contributed</u>
June 30, 2011	\$ 695,787	\$ 306,196	44.01%
June 30, 2012	695,787	334,032	48.01%
June 30, 2013	893,242	610,313	68.33%
June 30, 2014	893,242	634,125	70.99%
June 30, 2015	1,274,477	1,274,480	100.00%
June 30, 2016	1,274,477	1,274,480	100.00%

Kentucky Legislators Retirement Plan

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Annual Contribution</u>	<u>Percentage Contributed</u>
June 30, 2011	\$	\$	
June 30, 2012			
June 30, 2013			
June 30, 2014			
June 30, 2015			
June 30, 2016	5,207	5,207	100%

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON  
AN AUDIT OF THE FINANCIAL STATEMENT PERFORMED IN ACCORDANCE WITH  
*GOVERNMENT AUDITING STANDARDS***





MIKE HARMON  
AUDITOR OF PUBLIC ACCOUNTS

Report On Internal Control Over Financial Reporting And  
On Compliance And Other Matters Based On An Audit Of The Financial  
Statement Performed In Accordance With *Government Auditing Standards*

Independent Auditor's Report

Board of Trustees  
Kentucky Judicial Form Retirement System

We have audited, 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, the financial statements of the financial statements of the Kentucky Judicial Form Retirement System (System) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated November 23, 2016.

***Internal Control Over Financial Reporting***

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



Report On Internal Control Over Financial Reporting And  
On Compliance And Other Matters Based On An Audit Of Financial  
Statements Performed In Accordance With *Government Auditing Standards*  
(Continued)

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the System's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

***Purpose of this Report***

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mike Harmon", with a long horizontal line extending to the right.

Mike Harmon  
Auditor of Public Accounts

November 23, 2016