Kentucky School Boards Insurance Trust
Workers' Compensation Fund

Financial Statements

Years Ended June 30, 2011 and 2010

Kentucky School Boards Insurance Trust
Workers' Compensation Fund

Table of Contents
June 30, 2011 and 2010

Independent Auditor's Report on Financial Statements

To the Board of Trustees
Kentucky School Boards Insurance Trust
Workers' Compensation Fund

We have audited the accompanying statements of net deficit of Kentucky School Boards Insurance Trust Workers' Compensation Fund (Fund) as of June 30, 2011 and 2010 and the related statements of revenues, expenses and changes in net deficit, and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note H, the Fund has included in net deficit, a surplus note issued to the Kentucky League of Cities Insurance Service Association. Such inclusion in net deficit is allowed under the insurance laws of the Commonwealth of Kentucky but is not in accordance with accounting principles generally accepted in the United States.

In our opinion, except for the effects of the inclusion in net deficit, a surplus note as described in the preceding paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Kentucky School Boards Insurance Trust Workers' Compensation Fund as of June 30, 2011 and 2010 and the changes in its net deficit and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

175 East Main Street
Suite 200
Lexington, KY 40507

859.514.7800 Phone
859.514.7805 Fax
www.mcmcpa.com

Louisville
Lexington
Covington
Frankfort

The Management Discussion and Analysis on pages 3 - 5 and the claims development information included on page 18 are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. These sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Mountjoy Chilton Medley LLP

Lexington, Kentucky
October 26, 2011

Management Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky School Boards Insurance Trust Workers' Compensation Fund (the Fund) provides an overview of the Fund's financial activity for the fiscal year ended June 30, 2011. It should be read in conjunction with the financial statements, which begin on page 6.

Using This Annual Report

This report consists of a series of financial statements, notes to the financial statements, and supplemental information.

Statements of Net Deficit

The Kentucky League of Cities, Inc. (KLC) began administering the Kentucky School Board Insurance Trust (KSBIT) program on January 1, 2010, the middle of the July 2009 through June 2010 policy period. This resulted in the immediate transfer of responsibility for claims handling and loss control administration to KLC. The first underwriting and marketing responsibility for KLC relating to the KSBIT program begins with the July 2010 through June 2011 policy year. KSBIT and the Kentucky League of Cities Insurance Services Association (KLCIS) agreed on a plan under which KLCIS will help KSBIT meet statutory surplus requirements for the Property and Liability Fund and Workers' Compensation Fund and KLC will administer the Funds. In this agreement, KLCIS agreed to purchase from the Trust two surplus notes in the amount of $2,500,000 for the Property and Liability Fund and $5,500,000 for the Workers' Compensation Fund (see Note H). The proceeds of the surplus notes were applied by the Trust for the purpose of reducing the existing deficit in the Funds. In the agreement, the Kentucky School Boards Association (KSBA) agreed to endorse exclusively the Property and Liability Fund and Workers' Compensation Fund and to provide certain services to the Funds for a fee.

Table 1 shows all the assets and liabilities of the Fund and is presented on the accrual basis. Total net deficit increased $2,424,536 for the current fiscal year. The primary reasons for the loss relate to a combination of continued case reserve strengthening and actual claim severity on a few isolated instances that occurred very near to the year-end. The Trust believes that special consideration given to conservative loss reserving and a proactive approach to claims settling is paramount to its success on a going forward basis.

Table 1
Net Assets

	June 30, 2011	June 30, 2010
Cash and investments	$ 13,082,249	$ 17,829,320
Capital and other assets	4,204,476	2,501,883
Total assets	17,286,725	20,331,203
Unpaid losses and loss adjustment expenses	20,929,638	20,980,119
Other liabilities	276,577	846,038
Total liabilities	21,206,215	21,826,157
Total net deficit	$ (3,919,490)	$ (1,494,954)

Statements of Revenues, Expenses and Changes in Net Deficit

Table 2 shows the revenue and expenses of the Fund and is also presented on the accrual basis. Net earned premium revenue has increased $282,688 or 4.7% from the prior fiscal year, primarily due to taking an incremental average rate increase across the entire membership. Investment and other revenue and gains increased $458,775 compared to fiscal year 2010 due to favorable market conditions. General administrative expenses increased $407,533 or 25.7% over the prior year. Loss and loss adjustment expenses continued to increase in fiscal year 2011 by $244,240 or 3.5%. During the current year, the claims administrator continued to strengthen reserves on older files, while settling a substantial number of open claims. While the current claims administrator is still relatively new to the Trust (as of January 1, 2010), the resulting changes in historical payment patterns and reserving levels is a variable that the actuary continues to monitor and evaluate in determining the ultimate impact on overall loss reserves.

Table 2
Net Deficit

	Year Ended June 30, 2011	Year Ended June 30, 2010
Net premiums earned	$ 6,307,563	$ 6,024,875
Investment and other revenue and gains, net	570,559	111,784
Total revenues	6,878,122	6,136,659
Losses and loss adjustment expenses	7,308,647	7,064,407
General administrative expenses	1,994,011	1,586,478
Total expenses	9,302,658	8,650,885
Total change in net deficit	$ (2,424,536)	$ (2,514,226)

Description of Current Expected Conditions

In the upcoming year, the Fund expects considerable improvement from the prior year results. The basis for this expectation comes as a result of several factors including the following:

- Efficiency gains and economies of scale – The ability to combine resources, build upon existing relationships and benefit from the increased purchasing power in the reinsurance market provides real opportunities for potential and expected cost savings. Budgeted savings on the upcoming 2012 fiscal year in reinsurance costs are estimated to be over $250,000 for all lines combined.

- Investments – An independent investment consultant was engaged by the Board of Directors to work with existing investment managers on improving investment policies and strategies to maximize overall investment results.

- Claims administration – Since the transfer of claims administration, savings on prescription drugs has doubled as a result of a change in the medical bill review service provider and a shift from the use of formulary drugs to generics. For 2011, the Trust saved over $400,000 through this program and maintained generic drug prescription levels at nearly 73% of total prescriptions written. Additionally, the combination of standardizing legal rates and decreasing attorney travel time continued to generate savings over prior years' experience of legal-to-total claim cost ratios.

- Fee reductions – To assist with the expense load, several parties agreed to reduce fees for the good of the program going forward into the 2012 year. The reduction in fees from local agents and KSBA total approximately $600,000 for Liability, Property and Workers' Compensation.

Contacting the Fund's Financial Management

This financial report is designed to provide a general overview of Kentucky School Boards Insurance Trust Workers' Compensation Fund's finances and to show the Fund's accountability to its members. If you have any questions about this report or need additional information, contact the Kentucky League of Cities office at 100 East Vine Street, Suite 800, Lexington, KY 40507.

Kentucky School Boards Insurance Trust
Workers' Compensation Fund
Statements of Net Deficit
June 30, 2011 and 2010

	2011	2010
Assets		
Investment securities, at fair value	$ 11,944,434	$ 12,830,009
Cash and cash equivalents	1,137,815	4,999,311
Premium receivable (net of allowance for doubtful accounts of $10,000 and $2,932)	260,050	576,105
Reinsurance receivable	2,142,714	975,226
Receivable from related entity	1,718,340	751,185
Accrued investment income	71,570	49,609
Property and equipment (net of accumulated depreciation of $3,442 and $974)	8,905	8,764
Prepaid expenses	2,897	140,994
Total Assets	$ 17,286,725	$ 20,331,203
Liabilities and Net Deficit		
Unpaid losses and loss adjustment expenses:		
Reported claims	$ 12,796,658	$ 11,409,634
Incurred but not reported claims	8,132,980	9,570,485
Total Unpaid Losses and Loss Adjustment Expenses	20,929,638	20,980,119
Accounts payable	231,984	846,038
Advanced premiums	44,593	-
Total Liabilities	21,206,215	21,826,157
Net Deficit	(3,919,490)	(1,494,954)
Total Liabilities and Net Deficit	$ 17,286,725	$ 20,331,203

See accompanying notes.

Kentucky School Boards Insurance Trust
Workers' Compensation Fund
Statements of Revenues, Expenses and Changes in Net Deficit
Years Ended June 30, 2011 and 2010

	2011	**2010**
Operating Revenues		
Net premiums earned	$ 6,307,563	$ 6,024,875
Operating Expenses		
Losses and loss adjustment expenses	7,308,647	7,064,407
Commission expense	630,746	277,352
Claims administration expense	622,563	598,707
Professional fees	177,021	217,277
Program administrative fees	455,641	437,600
Other expenses	108,040	55,542
Total Operating Expenses	9,302,658	8,650,885
Operating Loss	(2,995,095)	(2,626,010)
Nonoperating Revenues (Expenses)		
Interest and investment revenue and gains, net	570,559	145,367
Miscellaneous expense	-	(33,583)
Change in net assets	(2,424,536)	(2,514,226)
Net Deficit at Beginning of Year	(1,494,954)	(4,480,728)
Capital surplus note	-	5,500,000
Net Deficit at End of Year	$ (3,919,490)	$ (1,494,954)

See accompanying notes.

Kentucky School Boards Insurance Trust
Workers' Compensation Fund
Statements of Cash Flows
Years Ended June 30, 2011 and 2010

	2011	2010
Cash Flows From Operating Activities		
Premiums collected	$ 6,668,211	$ 5,916,371
Losses and loss adjustment expenses paid	(7,359,128)	(6,213,088)
Underwriting expenses	(3,797,308)	(4,503,292)
Miscellaneous receipts	(804,835)	434,995
Net Cash Used by Operating Activites	(5,293,060)	(4,365,014)
Cash Flows From Investing Activities		
Purchases of investments	(26,741,654)	(45,192,914)
Proceeds from sale and maturities of investments	28,079,500	41,264,268
Interest and dividends received	371,327	389,651
Net Cash Provided/(Used) by Investing Activities	1,709,173	(3,538,995)
Cash Flows From Capital and Financing Activities		
Letter of credit financing fees	-	(33,583)
Surplus note	-	5,500,000
Interest paid on surplus note	(275,000)	(132,603)
Capital expenditures	(2,609)	(9,738)
Net Cash (Used)/Provided by Capital and Financing Activities	(277,609)	5,324,076
Net Decrease in Cash and Cash Equivalents	(3,861,496)	(2,579,933)
Cash and Cash Equivalents at Beginning of Year	4,999,311	7,579,244
Cash and Cash Equivalents at End of Year	$ 1,137,815	$ 4,999,311

See accompanying notes.

Kentucky School Boards Insurance Trust
Workers' Compensation Fund
Statements of Cash Flows (Continued)
Years Ended June 30, 2011 and 2010

	2011	2010
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (2,995,095)	$ (2,626,010)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation	2,468	974
Allowance for doubtful accounts	7,068	-
Changes in assets and liabilities		
Premium receivable	308,987	2,824
Reinsurance receivable	(1,167,488)	9,303,972
Receivable from related entity	(967,155)	(751,185)
Prepaid expenses	138,097	(111,762)
Unpaid losses and loss adjustment expenses	(50,481)	(9,160,659)
Accounts payable	(614,054)	658,511
Payable to related entity	-	(1,570,351)
Advance premiums	44,593	(111,328)
Net Cash Used by Operating Activities	$ (5,293,060)	$ (4,365,014)

See accompanying notes.

Note A – Nature of Organization and Operations

The Kentucky School Boards Insurance Trust (Trust) was organized by the Kentucky School Boards Association (Association), effective July 7, 1978. The Trust established a Workers' Compensation Fund to provide group self-insurance coverage for Association members and their related agencies. All school districts, non-profit institutions of higher education, and other tax supported agencies of Kentucky who are members of the Association are eligible to participate.

Participating members make contributions to the Fund based upon premium rates determined by the Fund. Members may be subject to contribution assessments in the event of deficiencies in the Fund's net assets. The Fund's management considers anticipated investment income, among other things, in determining if a premium deficiency exists. Distributions of excess net assets to participants in the form of dividends may be declared by the Board of Trustees, but under Kentucky Department of Insurance Regulations, dividends may not be paid until thirty-six months after the expiration of the self-insurance term. As of June 30, 2011 and 2010, the Fund had 89 and 82 participants.

The Trust has also sponsored and organized a Property and Liability Insurance Fund and an Unemployment Compensation Fund.

Effective January 1, 2010, the Trust and the Kentucky League of Cities Insurance Services Association (KLCIS) agreed on a plan under which KLCIS will help the Trust meet statutory surplus requirements for the Property and Liability Fund and Workers' Compensation Fund and KLCIS will administer the Funds. In this agreement, KLCIS agreed to purchase from the Trust two surplus notes in the amount of $2,500,000 for the Property and Liability Fund and $5,500,000 for the Workers' Compensation Fund (see Note H). The proceeds of the surplus notes were applied by the Trust for the purpose of funding the existing deficit in the Funds. In the agreement, the Kentucky School Boards Association (KSBA) agreed to endorse exclusively the Property and Liability Fund and Workers' Compensation Fund and to provide certain services to the Funds at a fee equal to one and one-quarter percent (1.25%) of annual gross billed premiums of the funds, but not to exceed $500,000 in any fiscal year.

Following is a description of the most significant risks facing workers' compensation insurers and how the Fund mitigates those risks:

Legal/Regulatory Risk:

Legal/regulatory risk is the risk that changes in the legal or regulatory environment in which an insurer operates will occur and create additional losses or expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits or new legal theories may create costs for the insurer beyond those currently recorded in the financial statements. The Fund is exposed to this risk by writing all of its business in Kentucky, thus increasing its exposure to a single jurisdiction. This risk is reduced by underwriting and loss adjusting practices that identify and minimize the adverse impact of this risk.

Credit Risk:

Credit risk is the risk that issuers of securities owned by an insurer will default or that other parties, including reinsurers that owe the insurer money will not pay. The Fund minimizes this risk by adhering to a conservative investment strategy, by utilizing financially sound reinsurers, by maintaining credit and collection policies, and by providing an allowance for any amounts deemed uncollectible.

Note A – Nature of Organization and Operations (Continued)

Interest Rate Risk:

Interest rate risk is the risk that interest rates will change and cause a decrease in the value of an insurer's investments. The Fund mitigates this risk by attempting to match the maturity schedule of its assets with the expected payouts of its liabilities. To the extent that such liabilities come due more quickly than assets mature, an insurer would have to sell assets prior to maturity and recognize a gain or loss. The Fund uses the segmented time distribution method to measure interest rate risk.

Note B – Summary of Significant Accounting Policies

1. <u>Basis of Presentation</u>: The Fund uses the accrual basis of accounting. Under this method, revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred.

   The Fund presents its financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units, with the exception of the surplus note, which has been included in net deficit as more fully described in NOTE H. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. As a proprietary activity, the Fund has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. Therefore, the Fund follows GASB pronouncements, Financial Accounting Standards Board (FASB) and predecessor boards' pronouncements issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements. The Fund also prepares its financial statements in accordance with accounting which Kentucky recognizes for determining solvency under Kentucky Insurance Law. Pursuant to Kentucky law, the DOI requires the Fund to report its financial condition using accounting principles generally accepted in the United States of America with certain prescribed exceptions as described above.

2. <u>Use of Estimates</u>: 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 reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

   Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of unpaid losses and loss adjustment expenses. In connection with the determination of unpaid losses and loss adjustment expenses, management uses the methodology described later in this note in *Unpaid Losses and Loss Adjustment Expenses*.

   Management believes that the liability for unpaid losses and loss adjustment expenses is adequate. While management uses available information to estimate unpaid losses and loss adjustment expenses, future changes to the liability may be necessary based on claims experience and changing claims frequency and severity conditions, as well as changes in doctrines of legal liability and damage awards in Kentucky. The future changes will be charged or credited to expenses when they occur.

Note B – Summary of Significant Accounting Policies (Continued)

3. Investment Securities: Investment securities consist of fixed maturity debt and equity securities that the Fund intends to use as a part of its asset/liability management policy and securities that may be sold in response to unexpected liquidity needs.

   Investment securities are stated at fair value based, generally, on quoted market prices. Changes in the fair value of investment securities are reported as revenue. The specific identification method is used to determine the cost of securities sold. Realized and unrealized gains and losses are included in non-operating revenue.

4. Cash and Cash Equivalents: Cash and cash equivalents consist principally of money market fund investments. For purposes of the statement of cash flows, the Fund considers all short-term investments with original maturities of three months or less to be cash equivalents.

5. Accounts Receivable: In accordance with accounting practices generally accepted in the insurance industry, the Fund records audit premiums as of the fiscal year-end in which they were earned. The allowance for doubtful accounts is an amount that management believes will be adequate to absorb possible uncollectible accounts based on prior experience. Amounts are charged against the allowance when management determines that collectibility is doubtful.

6. Property and Equipment: Property and equipment consists of furniture and fixtures. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. For the years ended June 30, 2011 and 2010, depreciation expense amounted to $2,468 and $974.

7. Premium Revenue: Premiums for contracts are recognized as earned on a pro rata basis over the contract period. Advance premiums relate to premiums paid by members for insurance coverage for the subsequent insurance period. Policy coverage is matched with revenue so as to result in recognition of profits over the life of the policies through establishment of reserves for incurred claims.

8. Unpaid Losses and Loss Adjustment Expenses: The provision for losses and loss adjustment expenses includes paid and unpaid claims and expenses associated with settling claims, including legal fees. The liability for unpaid losses and loss adjustment expenses is based on claims adjusters' evaluations of individual claims and management's evaluation and an actuarial review of experience with respect to the probable number and nature of claims arising from losses that have been incurred but have not yet been reported.

   The liability represents the estimated ultimate cost of settling the claims, including the effects of inflation and other societal and economic factors. Any adjustments resulting from the settlement of losses will be reflected in earnings at the time the adjustments are determined. To reflect its present value, the liability for unpaid losses and loss adjustment expenses has been discounted at 3.5% for 2011 and 2010. Discounting reduced the liability by $5,585,742 and $5,906,863 as of June 30, 2011 and 2010, respectively.

9. Federal Income Taxes: The Internal Revenue Service has ruled that the income of the Fund is excludable from gross income and, therefore, exempt from taxation pursuant to the Internal Revenue Code Section 115, which pertains to instrumentalities of state and local governments.

Note C – Deposits and Investments

The composition of the Fund's investment portfolio must meet certain criteria as set forth in the Kentucky Administrative Regulations. Investments held by the Fund as of June 30, 2011 and 2010 are as follows:

	2011	2010
Cash and cash equivalents	$ 344,534	$ 215,174
Money market mutual funds	793,281	4,784,137
Deposits and investments classified as cash and cash equivalents	1,137,815	4,999,311
U.S. Treasury notes and bonds	-	250,070
Certificates of deposit	2,138,273	4,202,710
Corporate bonds	1,474,109	1,140,630
Municipal bonds	2,938,952	2,232,993
Common equity securities	571,464	-
Equity mutual funds	3,230,025	1,434,194
U.S. government agency obligations	1,591,611	3,569,412
Investments classified as investment securities	11,944,434	12,830,009
Total deposits and investments	$ 13,082,249	$ 17,829,320

As of June 30, 2011, the Fund had the following investment maturities:

	Investment Maturities (In Years)			
	Less than 1	1-5	6-10	More than 10
Certificates of deposit	$ -	$ 2,138,273	$ -	$ -
Corporate bonds	-	105,864	1,368,245	-
Municipal bonds	494,331	863,089	421,749	1,159,783
U.S. government agency obligations	-	200,266	563,487	827,858
Total maturities	$ 494,331	$ 3,307,492	$ 2,353,481	$ 1,987,641

Note C – Deposits and Investments (Continued)

Investment and interest revenue and gains for assets limited to use, cash equivalents, and other investments are comprised of the following for the years ended June 30, 2011 and 2010:

	2011	2010
Interest and dividend income, net	$ 118,288	$ 174,628
Net realized and unrealized gain (loss)	452,271	(29,261)
	$ 570,559	$ 145,367

Credit Risk

State law asserts that corporate bonds are allowable if issued, assumed, or guaranteed by a solvent institution created and existing under the laws of the United States of America. It also states that corporate bond investments shall not exceed 25% of the total market value of the portfolio at the time of purchase and that the bond has a minimum rating of A.

State law also asserts that no individual equity holding shall comprise greater than 10% of the equity portion of the portfolio at the time of purchase. It also states that an investment in an individual holding shall not represent at the time of purchase more than 5% of the market value of the holding. Furthermore, state law states that investments in equities shall not exceed 20% of the total market value of the portfolio of the self-insurance group at the time of purchase. In addition, mutual funds and exchange traded funds are allowable and shall not exceed 20% of the total market value of the portfolio at the time of purchase.

With respect to cash and statute defined bonds, state law asserts that, of the total investments held, no less than 50% of the total market value shall be held in cash, cash equivalents, certificates of deposit and government bonds. Also, not less than 5% of the total investments shall be held in cash, cash equivalents or U.S. Treasury and federal agency securities with a remaining maturity of 1 year or less. The Fund may also invest surplus funds or reserves not needed for current obligations in the following: U.S. government bonds, U.S. Treasury notes and T-bills or other direct obligations guaranteed by the full faith and credit of the United States of America, tax exempt obligations issued by Kentucky or its agencies with a minimum Standard and Poor's (S&P) rating of A.

Furthermore, the Fund may also invest in obligations issued by a county, district, municipality or other legal authority within Kentucky with a minimum S&P rating of AA. Investments may also be made in investment share accounts in a savings and loan institution in Kentucky whose deposits are insured by a federal agency. Finally, the Fund may also invest in certificates of deposit if issued by a duly chartered commercial bank.

As of June 30, 2011 and 2010, the Fund's management believes the Fund is in compliance with all applicable laws. As of June 30, 2011 and 2010, the Fund was invested in the following government agency bonds: Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Home Loan Bank and Government National Mortgage Association. All of these bonds had AAA ratings. Additional investments include municipal bonds and money market accounts.

Note C – Deposits and Investments (Continued)

Concentration of Credit Risk

As of June 30, 2011 and 2010, more than 5% of the Fund's investments are in securities issued by the Federal Home Loan Bank. This investment represented 5% and 13% of the Fund's total investments as of June 30, 2011 and 2010, respectively.

Custodial Credit Risk - Deposits

Federal law provides temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts of all FDIC-insured depository institutions through December 31, 2012. As of June 30, 2011 and 2010, the Fund has no deposits in excess of federally insured limits. Cash equivalents include investments in a money market fund that are not federally insured.

Note D – Reinsurance Coverage

The Fund's Board of Trustees authorized the purchase of reinsurance coverage in order to reduce the ultimate loss exposure arising from large losses in the Workers' Compensation Pool. The Fund purchases specific excess of loss reinsurance coverage for protection against losses in excess of specified amounts per occurrence. In addition to specific excess of loss reinsurance, the Fund also maintained aggregate reinsurance coverage for fiscal years 2010 and prior. For 2011, the Fund elected not to purchase aggregate reinsurance. Reinsurance premiums are based upon a percentage of payrolls.

For 2011, the Fund purchased reinsurance coverage for the Workers' Compensation Pool from New York Marine and General Insurance Company, a reinsurance carrier with a rating of "A" (Excellent) by A.M. Best and Company. The Fund purchased a buffer layer of reinsurance, defined as $650,000 in excess of $350,000, as specific reinsurance coverage per occurrence. For 2010, The Workers' Compensation Pool also maintained aggregate reinsurance coverage for all aggregated losses above $7,958,318.

Although the purchase of reinsurance coverage does not discharge the Fund from its primary liability to its members, the reinsurance company that assumes the coverage assumes the related liability, and it is the practice of organizations such as the Fund for accounting purposes to treat insured risks, to the extent of reinsurance coverage, as though they were risks for which the Fund is not liable. However, the Fund remains contingently liable in the event its reinsurers are unable to meet their contractual obligations.

Reinsurance premiums ceded were $1,075,503 and $1,020,234 for the years ended June 30, 2011 and 2010, respectively. Reinsurance recoveries on paid claims during 2011 and 2010 were $1,403,443 and $1,545,443, respectively.

Note E – Liability for Unpaid Losses and Loss Adjustment Expenses

Activity in the liability for unpaid losses and loss adjustment expenses for the years ended June 30, 2011 and 2010 is summarized as follows:

	2011	2010
Net unpaid losses and loss adjustment expenses, beginning of year	$ 20,980,119	$ 20,128,800
Incurred losses and loss adjustment expenses:		
Provision for insured events of the current year	7,260,139	6,111,815
Increase in provision for insured events of prior years	48,508	952,592
Total incurred losses and loss adjustment expenses	7,308,647	7,064,407
Payments:		
Losses and loss adjustment expenses attributable to insured events of the current year	2,270,791	1,713,699
Losses and loss adjustment expenses attributable to insured events of prior years	5,088,337	4,499,389
Total payments	7,359,128	6,213,088
Net unpaid losses and loss adjustment expenses, end of year	$ 20,929,638	$ 20,980,119

An increase in the provision for insured events of prior years signifies that the Fund expects higher than anticipated ultimate losses in the final disposition of claims.

Note F – Related Party Transactions

Through December 31, 2009, the Fund occupied office space from and had an Administrative Agreement with Kentucky School Board Association (KSBA) to provide management and administrative services for the Fund. As of January 1, 2010, the KSBA agreed to endorse exclusively the Fund and to provide certain services to the Fund at a fee equal to one and one-quarter percent (1.25%) of annual gross billed premiums of the funds, but not to exceed $500,000 in any fiscal year. The amount paid to KSBA by the Fund was $92,284 and $254,276 for 2011 and 2010.

Amounts due to the Property and Liability Fund at June 30, 2011 and 2010 were $- and $8,978, respectively.

Note G – Commitments and Contingencies

The Fund is party to certain legal actions arising through the normal course of business. Management believes that these actions are without merit or that the ultimate liability, if any, will not materially affect the Fund's financial position or results of operations.

Note H – Surplus Note Agreement

In 2010, the Department of Insurance (DOI) approved the opportunity for the Kentucky League of Cities Insurance Service Association (KLCIS) to administer the Trust's program, provided that KLCIS issue an $8 million dollar surplus note receivable in exchange for an investment in the Trust. Of this total amount, $2.5 million was for the Property and Liability Fund and $5.5 million was for the Workers' Compensation Fund. The amount of the surplus note is classified as net assets by the Trust. Interest is due quarterly until the note is paid in full. Interest is calculated at a rate per annum which shall be equal to the sum of the year to date yield on the S&P Index weighted at twenty percent plus the year to date yield on the Bar Cap Index weighted at eighty percent. Provided, however, in no event shall the annual interest rate be less than one percent or greater than five percent. This note has no fixed maturity date. As the Trust gains increased financial stability KLCIS will recover the entire $8 million dollars either through repayment or alternate plan as deemed appropriate by the DOI.

Supplementary Information

KENTUCKY SCHOOL BOARDS INSURANCE TRUST WORKERS' COMPENSATION FUND

Claims Development Information (*Unaudited*)

Years ended June 30, 2002 through 2011

The following table illustrates how the Trust's contributions and investment income compare to related costs of claims incurred and other expenses of the Trust for each of the last ten years. The lines of the table are defined as follows: (1) Shows the total of each year's contributions earned and investment income. (2) Shows each year's expenses other than claims. (3) Shows incurred claims (both paid and accrued), as originally reported at the end of the first policy year. (4) shows the cumulative amounts paid, net of reinsurance received, as of the end of successive years for each policy year. (5) Shows how each policy year's incurred claims, net of reinsurance, increased or decreased as of the end of successive years. This annual reestimation results from new information received on known claims, reevaluation of existing information of known claims, as well as emergence of new claims not previously known. (6) Compares the latest reestimated incurred claims amount to the amount originally established (line 3), net of reinsurance, and shows whether this latest estimate of claims incurred is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years. The columns of the table show data for successive policy years.

	Workers' Compensation Pool Fiscal and Policy Year Ended									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
(1) Earned premium revenue and net investment income:	$ 5,844,142	$ 8,906,576	$ 9,962,643	$ 4,958,578	$ 9,020,633	$ 8,391,837	$ 7,251,756	$ 7,034,681	$ 6,170,242	$ 7,153,122
(2) Unallocated expenses	807,557	788,457	736,210	616,882	1,443,560	1,380,326	1,488,346	1,482,629	1,752,663	2,269,011
(3) Estimated incurred claims and expenses, end of policy year:	5,617,000	8,277,438	8,523,959	3,050,098	6,737,475	7,188,912	6,580,883	6,280,149	6,111,815	7,260,139
(4) Net paid (cumulative) as of:										
End of policy year	2,355,194	2,249,372	2,052,257	1,099,844	1,561,970	1,997,667	1,606,821	1,677,731	1,713,699	2,270,791
One year later	4,395,049	4,599,775	2,435,462	1,497,402	3,054,706	3,377,049	2,995,074	3,572,241	3,172,213	
Two years later	5,819,110	5,220,574	4,027,167	2,066,701	3,842,688	4,305,647	3,723,496	4,494,415		
Three years later	6,294,298	5,738,664	4,864,236	2,427,154	4,216,666	4,844,705	4,403,788			
Four years later	6,417,799	6,006,435	5,370,366	2,570,146	4,564,526	5,067,522				
Five years later	6,417,799	6,152,111	5,633,095	5,213,890	4,382,891					
Six years later	6,417,799	6,271,849	6,207,942	5,713,726						
Seven years later	6,417,799	4,813,349	6,410,585							
Eight years later	4,813,349	4,813,349								
Nine years later	4,813,349									
(5) Reestimated ceded claims and expenses	-	-	-	-	-	-	-	-	-	-
(6) Reestimated net incurred claims and expenses:										
End of policy year	5,617,000	8,277,438	8,523,959	3,050,098	6,737,475	7,188,912	6,580,883	6,280,149	6,111,815	7,260,139
One year later	7,013,750	8,512,221	8,531,642	3,336,863	6,415,393	6,823,373	5,672,366	6,413,224	6,131,030	
Two years later	8,328,989	8,554,905	7,988,934	3,408,718	5,882,910	6,459,344	5,897,951	6,503,962		
Three years later	8,398,991	8,543,700	7,944,695	3,480,446	5,787,434	6,882,232	6,154,515			
Four years later	8,583,258	8,062,255	7,986,005	3,511,626	6,358,315	6,853,386				
Five years later	7,852,555	8,024,665	7,979,903	6,949,924	5,820,017					
Six years later	7,838,210	8,068,519	8,162,566	6,955,274						
Seven years later	8,000,485	6,018,264	8,156,881							
Eight years later	6,018,264	5,717,341								
Nine years later	5,717,341									
(7) Increase (decrease) in estimated net incurred claims and expenses from the end of policy year	401,264	(2,259,174)	(361,393)	3,899,826	(379,160)	(306,680)	(682,932)	133,075	19,215	-

See accompanying independent auditor's report