KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Financial Statements

Years Ended June 30, 2013 and 2012
with Report of Independent Auditors

CONTENTS

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DEAN DORTON ALLEN FORD, PLLC

Report of Independent Auditors

Board of Trustees
Kentucky League of Cities Workers' Compensation Trust
Lexington, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Kentucky League of Cities Workers' Compensation Trust (the Trust) which comprise the statements of net position as of June 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit 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.

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 financial position of Kentucky League of Cities Workers' Compensation Trust as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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Board of Trustees
Kentucky League of Cities Workers' Compensation Trust
Report of Independent Auditors, continued

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 - 5 be presented to supplement the basic financial statements. Such information, although not a required 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 methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. 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 Information

The supplementary information on page 23 is presented for purposes of additional analysis and is not a required part of the financial statements but is supplementary information required by the Department of Insurance of the Commonwealth of Kentucky. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has not been subjected to the auditing procedures applied in the audits of the financial statements. Accordingly, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards,* we have also issued our report dated November 6, 2013 on our consideration of the the Trust's internal control over financial reporting and our tests 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 Trust's internal control over financial reporting and compliance.

Dean Dotton Allen Ford, PLLC

November 6, 2013
Lexington, Kentucky

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Management's Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky League of Cities (KLC) Workers' Compensation Trust (the Trust) provides an overview of the Trust's financial activity for the fiscal year ended June 30, 2013. It should be read in conjunction with the consolidated 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 Position

Table 1 shows all the assets and liabilities of the Trust and is presented on the accrual basis. Total net position decreased $2,376,791 for the current fiscal year as compared to a $1,546,305 increase during the prior fiscal year.

Table 1
Net Position

	2013	2012
Cash and investments	$ 47,745,887	$ 53,579,799
Capital and other assets	10,661,376	10,576,009
Total assets	58,407,263	64,155,808
Unpaid losses and loss adjustment expenses	32,809,457	31,686,257
Other liabilities	1,645,372	6,140,326
Total liabilities	34,454,829	37,826,583
Total net position	$ 23,952,434	$ 26,329,225

Statement of Revenues, Expenses and Changes in Net Position

Table 2 shows the revenues and expenses of the Trust and is also presented on the accrual basis. Net earned premium revenue has decreased by $563,010 or 5.4% from the prior fiscal year. Realized investment gains decreased compared to prior years and unrealized losses increased by $520,714 which attributed primarily to the 57.2% decline in total investment related revenues. The reason for the decline in the unrealized gain on the bond portfolio was due in large part to the rise in interest rates during June 2013. As interest rates increase, the market value of a bond will decline and as interest rates decrease, the market value of a bond will increase. Specifically, the market value of bonds held by KLCWC declined by 2.44% during the month of June due to this increase in rates. Since June, the Federal Reserve has softened its view on tapering bond purchases and interest rates have moved lower. Consequently, the KLCWC bond values have increased in value by 3.19% through October 31, 2013. In accordance with Government Accounting Standards Board (GASB) 31, the Trust must report all changes where the fair market value of investment holdings decreased below their carrying value as an unrealized loss during the current reporting year.

Table 2
Change in Net Position

Year ended June 30,	2013	2012
Net premiums earned	$ 9,849,912	$ 10,412,922
Investment and other revenue and gains	1,220,968	2,852,290
Total revenue	11,070,880	13,265,212
Losses and loss adjustment expenses	9,042,504	7,642,559
General administrative expenses	4,405,167	4,076,348
Total expenses	13,447,671	11,718,907
Change in net position	$ (2,376,791)	$ 1,546,305

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Management's Discussion and Analysis (*Unaudited*), continued

Description of Current and Expected Conditions

KLCIS has recently made the decision to have workers compensation claims adjusted by an internal staff. It is our belief we can incur less costs in the adjudication process verses the services of a third party claims administrator. We have the nucleus of that operation currently on staff, including supervision, and are in the process of hiring to staff the remainder of this unit. We have increased loss control visits and additional resources have been allocated to fine tune the score card program and to equip members with the resources necessary to effectively conduct monthly safety meetings. This decision, combined with the increased emphasis by loss control and underwriting, we believe will translate to reduced costs, increased control of claims and stabilization of rates for our members.

Contacting the Organization's Financial Management

This financial report is designed to provide a general overview of 2013's finances and to show the Trust'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 LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Net Position

June 30, 2013 and 2012

	2013	2012
Assets		
Investment securities, at fair value	$ 44,652,093	$ 43,161,873
Cash and cash equivalents	3,093,794	10,417,926
Accounts receivable, net of allowance for doubtful accounts of $25,000 and $20,000 in 2013 and 2012, respectively	241,192	305,455
Reinsurance receivable	1,514,708	1,531,016
Accrued investment income	316,007	357,013
Prepaid expenses	54,690	75,854
Membership in NLC Mutual Insurance Company	241,255	241,255
Equipment, net of accumulated depreciation of $1,204,176 and $1,222,685 for 2013 and 2012, respectively	93,524	65,416
Surplus note receivable	8,000,000	8,000,000
Surplus note interest receivable	200,000	-
Total assets	58,407,263	64,155,808
Liabilities		
Unpaid losses and loss adjustment expenses:		
Reported claims	22,149,843	15,529,079
Incurred but not reported claims	9,429,185	15,064,992
Unallocated loss adjustment expenses	1,230,429	1,092,186
Total unpaid losses and loss adjustment expenses	32,809,457	31,686,257
Accounts payable	306,403	602,805
Payable to related entity	502,875	4,442,594
Advance premiums	836,094	1,094,927
Total liabilities	34,454,829	37,826,583
Net Position		
Net position	$ 23,952,434	$ 26,329,225

See accompanying notes.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Revenues, Expenses and Changes in Net Position

Years ended June 30, 2013 and 2012

	2013	2012
Operating revenue:		
Net premiums earned	$ 9,849,912	$ 10,412,922
Operating expenses:		
Losses and loss adjustment expenses	9,042,504	7,642,559
Commission expense	986,500	764,439
Claims administration expense	1,002,246	994,321
Loss prevention expenses	191,282	166,800
Professional fees	280,010	155,163
Administrative fees, related entity	1,756,178	1,795,061
Other expenses	188,951	200,564
Total operating expenses	13,447,671	11,718,907
Operating loss	(3,597,759)	(1,305,985)
Nonoperating revenue:		
Interest and investment revenue	1,220,968	2,852,290
Change in net position	(2,376,791)	1,546,305
Net position, beginning of year	26,329,225	24,782,920
Net position, end of year	$ 23,952,434	$ 26,329,225

See accompanying notes.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Cash Flows

Years ended June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Premiums collected	$ **9,650,342**	$ 10,793,829
Losses and loss adjustment expenses paid	**(7,919,304)**	(7,376,690)
Underwriting expenses paid	**(7,859,617)**	(2,915,380)
Other (payments) receipts	**(721,704)**	69,547
Net cash (used in) provided by operating activities	**(6,850,283)**	571,306
Cash flows from investing activities:		
Purchases of investments	**(52,767,989)**	(25,219,725)
Proceeds from sale of investments	**49,901,394**	28,323,342
Interest and dividends received	**2,438,349**	2,829,810
Net cash (used in) provided by investing activities	**(428,246)**	5,933,427
Cash flows from capital and related financing activities:		
Capital expenditures	**(45,603)**	(63,625)
Net cash used in financing activities	**(45,603)**	(63,625)
Net (decrease) increase in cash and cash equivalents	**(7,324,132)**	6,441,108
Cash and cash equivalents, beginning of year	**10,417,926**	3,976,818
Cash and cash equivalents, end of year	$ **3,093,794**	$ 10,417,926

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Cash Flows, continued

Years ended June 30, 2013 and 2012

	2013	2012
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	$ **(3,597,759)**	$ (1,305,985)
Adjustments:		
Depreciation	**17,495**	7,163
Provision for doubtful accounts	**5,000**	-
Increase (decrease) in cash due to changes in:		
Accounts receivable	**59,263**	(105,574)
Reinsurance receivable	**16,308**	(335,943)
Prepaid expenses	**21,164**	7,016
Unpaid losses and loss adjustment expenses	**1,123,200**	265,869
Accounts payable	**(296,402)**	411,095
Payable to related entity	**(3,939,719)**	1,141,184
Advance premiums	**(258,833)**	486,481
Net cash (used in) provided by operating activities	$ **(6,850,283)**	$ 571,306

See accompanying notes.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements

1. Description of Organization

Effective July 1, 1978, the Kentucky Association of Counties (KACo) and the Kentucky League of Cities, Inc. (KLC) formed the KACo-KLC Self-Insurance (KACo-KLC Fund). The KACo-KLC Fund was formed as a joint city/county group workers' compensation self-insurance fund.

Effective June 30, 1993, the KACo-KLC Fund ceased writing new business. In July 1, 1993, both KACo and KLC formed new, separate group workers' compensation self-insurance funds for their respective members. Kentucky League of Cities Workers' Compensation Trust (the Trust) was established under the authorization of the Kentucky Interlocal Cooperation Act of the Kentucky Revised Statues. It is an unincorporated, nonprofit trust voluntarily established by the participating cities, urban-county governments and related public agencies and political subdivisions within the Commonwealth of Kentucky.

The Trust has received a Certificate of Filing from the Department of Insurance of the Commonwealth of Kentucky but is exempt from most statutory requirements that commercial insurers must follow. The Trust's general objectives are to formulate, develop and administer, on behalf of the member political subdivisions, a workers' compensation insurance program and to obtain lower costs for that coverage. All coverages are written on an occurrence basis. Participation in the Trust included 406 and 385 members as of June 30, 2013 and 2012, respectively.

On July 1, 1995 the assets, liabilities, and responsibility for effective claims administration stemming from existing open claims obligations of the KACo-KLC Fund were divided proportionally between the KACo Fund and the Trust. The Trust's portion of the KACo-KLC Fund is known as the Prior Workers' Compensation Fund, which is now a component of the Trust.

Following is a description of the most significant risks facing property/casualty insurers and how the Trust 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 cost for the insurer beyond those currently recorded in the financial statements. The Trust 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 Trust 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.

1. Description of Organization, 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 Trust mitigates this risk by attempting to match the maturity schedule of its assets with the expected payouts of its liabilities. To the extent that liabilities come due more quickly than assets mature, an issuer would have to sell assets prior to maturity and recognize a gain or loss. The Trust uses the segmented time distribution method to measure interest rate risk.

2. Summary of Significant Accounting Policies

Basis of Accounting

The Trust 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 Trust presents its financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. 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. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.* Therefore, the Trust follows GASB pronouncements and all Financial Accounting Standards Board and predecessor boards' pronouncements except those that conflict with or contradict GASB pronouncements.

For 2013, the Trust implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.*

GASB Statement No. 63 identifies net position, rather than net assets, as the residual of all other elements presented in a statement of financial position. This change was incorporated in the Trust's 2013 financial statements; however, there was no effect on beginning net position/fund balance.

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 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 footnote in "Unpaid Losses and Loss Adjustment Expenses."

2. Summary of Significant Accounting Policies, continued

Use of Estimates, continued

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.

Investment Securities

Investment securities consist of fixed maturity debt and equity securities that the Trust intends to use as 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 interest and investment revenue, reported within nonoperating revenue.

The investment in the NLC Mutual Insurance Company is carried at cost as required by the Kentucky Department of Insurance.

Cash and Cash Equivalents

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

Accounts Receivable

In accordance with accounting principles generally accepted in the insurance industry, the Trust 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 collectability is doubtful.

Equipment

Equipment consists of computer equipment and related software net of accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets.

2. Summary of Significant Accounting Policies, continued

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. All policy years coincide with the Trust's fiscal year.

Unpaid Losses and Loss Adjustment Expenses

Unpaid losses and loss adjustment expenses are based on estimates of the ultimate cost of claims (including future claims adjustment expense) that have been reported but not settled, and of claims that have been incurred but not yet reported. The length of time for which such costs must be estimated varies depending on the coverage involved. Estimated amounts of salvage, subrogation and reinsurance recoverable on unpaid claims are deducted from the liability for unpaid claims. Because actual claims cost depends on such complex factors as inflation, changes in doctrines of legal liability, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.

To reflect its present value, the liability for unpaid losses and loss adjustment expenses has been discounted at 3% for both 2013 and 2012. Discounting reduced the liability by $5,939,121 and $5,537,134 as of June 30, 2013 and 2012, respectively. The effect of discounting on the provision for losses and loss adjustment expenses was a decrease of $401,987 in 2013 and an increase of $187,304 in 2012.

Reinsurance

Reinsurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums, losses, and loss adjustment expenses are reported net of reinsured amounts. The Trust evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. The Trust holds funds and collateral as security under reinsurance agreements in the form of letters of credit for any reinsurers not subject to the regulation of the Kentucky Commissioner of Insurance. In the opinion of management, all amounts due from reinsurers at June 30, 2013 and 2012 are recoverable.

2. Summary of Significant Accounting Policies, continued

Net Position

The Board of Trustees may, at its discretion, refund to members the savings, if any, resulting from operations of the Trust in the form of dividends or reduced premiums. The amount of any future dividends or reductions in premiums is dependent on the Trust's ultimate liability for claims incurred and, accordingly, the amount may differ from the net position. No refunds were issued during 2013 or 2012.

In the event of adverse loss experience, the Trust can assess additional amounts to the members. An assessment would be computed and established by the Board of Trustees with each member's share being in proportion to their annual premiums, relative to premiums of all members. Capital contributions are refundable only at the discretion of the Board of Trustees. There have been no assessments levied since the inception of the Trust.

Federal Income Taxes

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

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through November 6, 2013, the date that the financial statements were available to be issued. Other than as discussed at Note 8, there were no events occurring during the evaluation period that require recognition or disclosure in the financial statements.

3. Deposits and Investments

The composition of the Trust's investment portfolio must meet certain criteria as set forth in the Kentucky Administrative Regulations. Investments held by the Trust as of June 30, 2012 and 2011 are as follows:

	2013	2012
Deposits and investments classified as cash and cash equivalents:		
Cash and cash equivalents	$ 1,132,403	$ 4,141,617
Money market mutual funds and uninvested cash	1,961,391	6,276,309
	3,093,794	10,417,926
Investments classified as investment securities:		
Corporate bonds	786,828	574,025
Municipal bonds	34,329,371	15,789,281
U.S. government agency funds	-	19,574,044
Equity securities	2,215,275	1,248,005
Equity mutual funds	7,320,619	5,976,518
	44,652,093	43,161,873
Total deposits and investments	$ 47,745,887	$ 53,579,799

As of June 30, 2013, the Trust had the following investment maturities in years:

	Less than 1	1-5	6-10	More than 10
Corporate bonds	$ -	$ 288,033	$ -	$ 498,795
Municipal bonds	926,548	10,557,025	9,499,542	13,346,256
Total maturities	$ 926,548	$ 10,845,058	$ 9,499,542	$ 13,845,051

Interest and investment revenue is comprised of the following for the years ended June 30, 2013 and 2012:

	2013	2012
Interest and dividend income	$ 1,826,213	$ 2,081,787
Realized gain on sales of securities	571,130	1,626,163
Interest from surplus note receivable	200,000	-
Unrealized loss on securities	(1,376,375)	(855,661)
	$ 1,220,968	$ 2,852,289

3. Deposits and Investments, continued

Credit Risk

State law and the Trust investment guidelines assert 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. They also state that corporate bond investments shall not exceed 15% 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 and the Trust investment guidelines assert that no individual equity holding shall comprise greater than 10% of the equity portion of the portfolio at the time of purchase. Both also state 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, both state 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 that are registered investment advisors licensed by the Securities Exchange Commission and Commonwealth of Kentucky to perform investment services 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 statue defined bonds, both sets of guidelines state that, of the total investments held, no less than 75% of the total market value shall be held in cash, cash equivalents, and fixed income. Also, not less than 15% of the total investments shall be held in cash, cash equivalents or U.S. Treasuries and federal agency securities with a 1 year or less maturity. The Trust may also invest surplus funds or reserves not needed for current obligations in the following: U.S. government bonds, 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&P) rating of A.

Furthermore, the Trust may also invest in obligations issued by a country, 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 which is insured by the Federal Deposit Insurance Corporation. Finally, the Trust may also invest in certificates of deposit if issued by a duly chartered commercial bank in Kentucky.

As of June 30, 2013, the Trust was invested in municipal and corporate bonds, common stocks and mutual funds. Of these bonds that were rated, all ranged in ratings from A to AAA. The Trust also invested in money market funds that were not rated.

Concentration of Credit Risk

More than 5% of the Trust's investments are in securities issued by Kentucky State Property and Building Commission. These investments represent 5.3% of the Trust's total investments.

3. Deposits and Investments, continued

Custodial Credit Risk - Deposits

The Trust maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Trust has not experienced any losses in such accounts. Management believes it is not exposed to any significant credit risk related to cash. Cash equivalents include investments in a money market fund that are not federally insured.

4. Reinsurance Coverage

For the years ended June 30, 2013 and 2012, respectively, the Trust purchased specific reinsurance coverage from Safety National, an "A" (Excellent) rated insurer rated by A.M. Best and Company, and ACE, an "A+" (Superior) rated insurer by A.M. Best and Company, respectively, for the excess layer of insurance only to cover losses in excess of $1,000,000. The Trust must self-insure up to the $1,000,000 per occurrence limit. For 2013 and 2012, employer's liability loss limitations were $4,000,000 (retention of $1,000,000 plus $3,000,000 of reinsurance).

Although the purchase of reinsurance coverage does not discharge the Trust from it 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 Trust for accounting purposes to treat insured risks, to the extent of reinsurance coverage, as though they were risks for which the Trust is not liable. However, the Trust remains contingently liable in the event its reinsurers are unable to meet their contractual obligations.

Reinsurance premiums ceded were $784,959 and $738,366 for the years ended June 30, 2013 and 2012, respectively. Additional recoveries accrued on paid claims during 2013 and 2012 were $614,252 and $935,311, respectively. The liability for unpaid losses and loss adjustment expenses has been reduced to reflect reinsurance recoverables on policy case reserves and estimated recoverables on claims incurred but not reported by $6,767,591 and $4,939,622 in 2013 and 2012, respectively.

5. Letter of Credit

To satisfy requirements of the Department of Insurance of the Commonwealth of Kentucky, the Trust maintains a letter of credit with a bank with permitted borrowings of $3.3 million as of June 30, 2013, renewable annually. As of June 30, 2013 and 2012, no amounts were outstanding under the letter of credit.

6. Related Party Transactions

The following entities are KLCIS related entities:

Kentucky League of Cities (KLC)
Kentucky League of Cities Insurance Agency (KLCIA)
Kentucky League of Cities Premium Finance Company (KLCPFC)
Kentucky League of Cities Unemployment Compensation Reimbursement Trust (KLCUCRT)

6. Related Party Transactions, continued

Kentucky League of Cities Insurance Services Association (KLCIS)
Kentucky School Boards Insurance Trust Workers Compensation Fund (KSBITWCF)
Kentucky School Boards Insurance Trust Property and Liability Fund (KSBITPLF)

The Trust was organized by KLC at the request of the state municipalities. KLC provides substantially all of the Trust's operational, management and administrative services in exchange for an administrative fee based on allocated costs plus a percentage of earned premiums. Total administrative fees under the agreement amounted to $1,756,178 and $1,795,061 for the years ended June 30, 2013 and 2012, respectively.

The Trust participates in a marketing agreement with Kentucky League of Cities Insurance Agency (the Agency) which provides that the Trust pay a commission for member accounts marketed or serviced by the Agency. Commission expense under the agreement was $337,034 and $359,170 for the years ended June 30, 2013 and 2012, respectively.

The Trust's directors' and officers' insurance provides coverage for KLC board members. Also, certain trustees of the Trust are directors of KLC.

The Trust reports amounts as being due from or due to related parties. Related party receivables and payables included within the Trust's statements of net assets consist of the following as of June 30:

	2013	2012
KLC accounts (payable) receivable	$ (150,019)	$ 227,711
KLCUCRT accounts receivable	-	997,385
KSBITPLF accounts receivable	-	141,667
KLCPFC accounts (payable) receivable	(531)	330,875
KLCIS accounts payable	(330,051)	(5,868,928)
KLCIA accounts payable	(22,274)	(271,304)
Total due to related entities	$ (502,875)	$ (4,442,594)
KSBITWCF notes and interest receivables	$ 5,625,000	$ 5,500,000
KSBITPLF notes and interest receivables	2,575,000	2,500,000
KSBITPLF accounts receivable	-	141,667
Total due from related entities	$ 8,200,000	$ 8,141,667

7. 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, 2013 and 2012 is summarized as follows:

	2013	2012
Net unpaid losses and loss adjustment expenses, beginning of year	$ 31,686,257	$ 31,420,388
Incurred losses and loss adjustment expenses:		
Provision for insured events of the current year	8,870,000	8,396,000
Increase (decrease) in provision for insured events of prior years	172,504	(753,441)
Total incurred losses and loss adjustment expenses	9,042,504	7,642,559
Payments:		
Losses and loss adjustment expenses attributable to insured events of the current year	1,903,747	2,166,759
Losses and loss adjustment expenses attributable to insured events of prior years	6,015,557	5,209,931
Total payments	7,919,304	7,376,690
Net unpaid losses and loss adjustment expenses, end of year	$ 32,809,457	$ 31,686,257

An increase (decrease) in the provision for insured events of prior years signifies that the Trust expects higher (lower) than anticipated ultimate losses in the final disposition of claims.

8. Surplus Note Agreement

At the direction and approval of the Department, on January 6, 2010, KLCIS loaned $5,500,000 to KSBIT for its workers' compensation fund and loaned $2,500,000 to KSBIT for its property and liability self-insurance fund, which is evidenced by two surplus notes. Interest on the notes is due quarterly until the notes are 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 20% plus the year to date yield on the Bar Cap Index weighted at 80%. Provided, however, in no event shall the annual interest rate be less than 1% or greater than 5%.

8. Surplus Note Agreement, continued

At the time KLCIS made the loans to KSBIT, the Department stated to KLCIS, KLC and KSBIT that to the extent that KSBIT was unable to generate a surplus from operating the self-insurance funds sufficient to repay the loans, KSBIT would be required to assess its members to repay the loans. In late September 2013, the Department changed its position and indicated that it does not believe an assessment should include the repayment of the $8,000,000 loans to KLCIS. KLCIS disagrees with the Department and filed a Declaratory Action against the Department on November 5, 2013 seeking a determination that assessments for the KSBIT workers' compensation fund and for the KSBIT property and liability fund must include assessments for all fund obligations including the surplus notes and in the alternative, that the Department is liable for the amount of the notes on the grounds of negligent misrepresentation. Although KLCIS believes it should prevail in the litigation, it is too early to determine the outcome of that action.

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DEAN DORTON ALLEN FORD, PLLC

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Trustees
Kentucky League of Cities Workers' Compensation Trust
Lexington, Kentucky

We have audited, in accordance with the 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 Kentucky League of Cities Workers' Compensation Trust (the Trust) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Trust's basic financial statements, and have issued our report thereon dated November 6, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Trust'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 Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Trust'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 a 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 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Trust'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*.

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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 Trust's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dean Dorton Allen Ford, PLLC

November 6, 2013
Lexington, Kentucky

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Claims Development Information (*Unaudited*)

Years ended June 30, 2004 through 2013

The following table illustrates how the Association's earned premium revenue (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Association as of the end of each of the last ten years. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's gross premium revenue and investment revenue, premium revenue ceded to reinsurers, and net earned premium revenue and reported investment revenue. (2) This line shows each fiscal year's other operating costs of the Association including overhead and claims expense not allocable to individual claims. (3) This line shows the Association's gross incurred claims and allocated claims adjustment expenses, claims assumed by reinsurers, and net incurred claims and allocated adjustment expenses (both paid and accrued) as originally reported as of the end of the first year in which the event that triggered coverage under the contract occurred (called policy year). (4) This section shows the cumulative net amounts paid as of the end of successive years for each policy year. (5) This line shows the latest reestimated amount of claims assumed by reinsurers as of the end of the current year for each accident year. (6) This section shows how each policy year's net incurred claims 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 on known claims, and emergence of new claims not previously known.) (7) This line compares the latest reestimated net incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of net claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts commonly is used to evaluate the accuracy of net incurred claims currently recognized in less mature policy years. The columns of the table show data for successive policy years.

		Fiscal and Policy Year Ended									
		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
(1)	Earned premium revenue and net investment income:										
	Earned	$ 14,391,623	$ 16,880,970	$ 16,141,308	$ 19,578,024	$ 17,552,153	$ 15,325,296	$ 18,454,798	$ 16,853,253	$ 14,003,578	$ 11,855,839
	Ceded	830,510	1,089,205	1,095,237	1,700,660	1,340,759	1,219,481	1,368,978	847,592	738,366	784,959
	Net earned	13,561,113	15,791,765	15,046,071	17,877,364	16,211,394	14,105,815	17,085,820	16,005,661	13,265,212	11,070,880
(2)	Unallocated expenses	4,014,435	3,886,286	3,155,633	3,641,177	3,744,228	3,685,385	3,435,931	4,161,830	4,076,352	4,405,167
(3)	Estimated incurred claims and expenses, end of policy year:										
	Incurred	12,500,000	10,400,000	11,810,000	12,060,000	12,000,000	10,980,000	9,300,000	9,280,000	8,396,000	8,870,000
	Ceded	518,242	-	-	-	-	-	-	-	-	-
	Net incurred	11,981,758	10,400,000	11,810,000	12,060,000	12,000,000	10,980,000	9,300,000	9,280,000	8,396,000	8,870,000
(4)	Net paid (cumulative) as of:										
	End of policy year	2,947,856	2,615,508	3,050,893	2,918,294	2,242,501	2,625,675	2,173,724	2,412,348	2,166,759	1,903,747
	One year later	5,934,955	5,241,080	5,615,096	5,710,452	3,713,329	4,582,157	4,267,533	4,305,129	4,210,478	
	Two years later	7,536,842	6,681,882	7,138,085	7,439,053	4,700,280	5,962,097	5,408,939	5,732,604		
	Three years later	8,694,677	7,469,538	7,638,292	8,400,115	5,134,088	6,829,093	5,824,803			
	Four years later	9,584,453	7,774,517	8,087,935	8,995,800	5,424,794	7,598,442				
	Five years later	10,407,571	7,970,650	8,386,011	9,258,624	5,746,855					
	Six years later	10,698,540	8,080,195	8,513,158	9,453,920						
	Seven years later	11,031,694	8,317,300	8,662,775							
	Eight years later	11,241,048	8,428,436								
	Nine years later	11,428,018									
(5)	Reestimated ceded claims and expenses	518,242	-	-	-	-	-	-	-	-	-
(6)	Reestimated net incurred claims and expenses:										
	End of policy year	12,500,000	10,400,000	11,810,000	12,060,000	12,000,000	10,980,000	9,300,000	9,280,000	8,396,000	8,870,000
	One year later	12,370,000	10,300,000	11,536,000	12,866,000	10,250,000	10,580,000	9,000,000	8,770,000	8,700,000	
	Two years later	12,250,000	10,440,000	11,306,000	12,099,000	9,370,000	10,300,000	8,360,000	9,730,000		
	Three years later	11,611,000	10,025,000	10,812,000	12,055,000	8,240,000	10,560,000	8,525,000			
	Four years later	12,796,000	9,661,000	10,796,000	11,772,000	7,270,000	10,680,000				
	Five years later	13,429,000	9,396,000	10,512,000	12,104,000	7,240,000					
	Six years later	13,273,000	9,682,000	10,467,000	12,182,000						
	Seven years later	13,015,000	9,771,000	10,265,412							
	Either years later	13,105,108	9,465,367								
	Nine years later	13,018,045									
(7)	Increase (decrease) in estimated net incurred claims and expenses from the end of the policy year	1,036,287	(934,633)	(1,544,588)	122,000	(4,760,000)	(300,000)	(775,000)	450,000	304,000	-

See report of independent auditors.