KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

FINANCIAL STATEMENTS AND SUPPLEMENTAL INFORMATION

Years Ended June 30, 2010 and 2009

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

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June 30, 2010 and 2009

Mountjoy
Chilton
Medley

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of
Kentucky League of Cities Workers' Compensation Trust

We have audited the accompanying statements of net assets of Kentucky League of Cities Workers' Compensation Trust (the "Trust") as of June 30, 2010 and 2009 and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2010 and 2009 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2010 on our consideration of Kentucky League of Cities Workers' Compensation 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit

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The Management Discussion and Analysis on pages 3 - 4 and the claims development information included on page 19 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 27, 2010

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Management Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky League of Cities Workers' Compensation Trust (the Trust) provides an overview of the Trust's financial activity for the fiscal year ended June 30, 2010. 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 Assets

Table 1 shows all the assets and liabilities of the Trust and is presented on the accrual basis. Total net assets increased $6,386,175 for the current fiscal year as compared to a $1,592,241 increase during the prior fiscal year. Most of the favorable result was due to a change in the investment markets, where investment income increased by $5,680,010, as compared to the prior year's overall investment losses. Of the current year's investment income, most of this return comes from unrealized gains (or market appreciation) on the investment holdings held by the Trust. Additional factors that contributed to the current year's overall success were an overall downward trend in loss costs for Workers' Compensation in the state of Kentucky and more efficient claims handling to settle older claims for less than reserved amounts.

Table 1
Net Assets

	June 30, 2010	June 30, 2009
Cash and investments	$ 47,411,627	$ 51,864,555
Capital and other assets	10,882,603	3,007,928
Total assets	58,294,230	54,872,483
Unpaid losses and loss adjustment expenses	31,653,696	33,029,557
Other liabilities	5,893,927	7,482,494
Total liabilities	37,547,623	40,512,051
Total net assets	$ 20,746,607	$ 14,360,432

Statements of Revenues, Expenses and Changes in Net Assets

Table 2 shows the revenue and expenses of the Trust and is also presented on the accrual basis. Net earned premium revenue has decreased $(2,507,128) or (17.3)% from the prior fiscal year. General administrative expenses decreased 7.7% as compared to the (17.3)% decrease in net earned premiums. The current economic conditions continued to pave the way for efficient claims management during the year. As the market gained greater stability during the current year, the Trust's investments showed considerable recovery to value previously lost through unrealized market appreciation. In essence, the holdings of the Trust recaptured most of their true value, which is recognizable as income to be in conformance with Governmental Accounting Standards Board (GASB) 31.

The Trust management records loss estimates to the actuarial determined best estimate.

Table 2
Net Assets

	Year Ended June 30, 2010	Year Ended June 30, 2009
Net premiums earned	$ 11,996,525	$ 14,503,653
Investment and other revenue (expense) and gains (losses)	5,282,172	(397,838)
Total revenues	17,278,697	14,105,815
Losses and loss adjustment expenses	6,375,758	7,621,769
General administrative expenses	4,516,764	4,891,805
Total expenses	10,892,522	12,513,574
Total change in net assets	$ 6,386,175	$ 1,592,241

Description of Current Expected Conditions

During the current year, the Trust entered into a management agreement with the Kentucky School Board's Insurance Trust (KSBIT) to manage its insurance program pertaining to its Liability, Property and Workers' Compensation Trusts. The Kentucky Office of Insurance (KOI) approved the opportunity for the Trust to administrate the program provided the Trust issue an $8 million dollar surplus note receivable in exchange for the investment in KSBIT as well as a restriction to its surplus for the same amount. The financial structure of the deal provided economies of scale in management as well as an opportunity to create synergy without substantively changing the financial position and cumulative surplus level of the Trust. As KSBIT gains increased financial stability, the entire $8 million dollars will be recovered either through repayment or alternate plan, as deemed appropriate by the KOI. Until such date, interest will accrue on the outstanding principle balance, based on a weighted index, with a floor of 1% APR and a ceiling of 5% APR. The Trust believes the economies of scale gained through this arrangement will be a significant benefit to the bottom line of all of the insurance pools in the state of Kentucky.

Contacting the Trust's Financial Management

This financial report is designed to provide a general overview of Kentucky League of Cities Workers' Compensation Trust'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 ASSETS

June 30, 2010 and 2009

	2010	2009
ASSETS		
Investment securities, at fair value	$ 42,420,107	$ 41,481,732
Cash and cash equivalents	4,991,520	10,382,823
Accounts receivable (net of allowance for doubtful accounts of $18,120 and $20,000 for 2010 and 2009, respectively)	736,547	644,767
Reinsurance receivable	1,130,666	936,557
Accrued investment income	339,428	386,841
Membership in NLC Mutual Insurance Company	241,255	241,255
Equipment (net of accumulated depreciation of $1,208,358 and $1,201,194 for 2010 and 2009, respectively)	16,118	23,282
Receivable from related entity	-	670,696
Surplus note receivable	8,000,000	-
Other assets	418,589	104,530
Total assets	$ 58,294,230	$ 54,872,483
LIABILITIES AND NET ASSETS		
Unpaid losses and loss adjustment expenses:		
Reported claims	$ 10,042,354	$ 11,205,563
Incurred but not reported claims	20,760,723	21,024,734
Unallocated loss adjustment expenses	850,619	799,260
Total unpaid losses and loss adjustment expenses	31,653,696	33,029,557
Accounts payable	451,366	737,658
Payable to related entity	3,626,055	-
Advance premiums	1,816,506	6,744,836
Total liabilities	37,547,623	40,512,051
Net Assets	20,746,607	14,360,432
Total liabilities and net assets	$ 58,294,230	$ 54,872,483

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

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended June 30, 2010 and 2009

	2010	2009
Operating revenue		
Net premiums earned	$ 11,996,525	$ 14,503,653
Operating expenses		
Losses and loss adjustment expenses	6,375,758	7,621,769
Commission expense	698,720	818,388
Claims administration expense	1,200,873	1,206,419
Loss prevention expense	104,015	80,476
Professional fees	242,824	162,145
KLC administrative fees	1,924,289	2,288,144
Other expenses	346,043	336,233
Total operating expense	10,892,522	12,513,574
Operating income	1,104,003	1,990,079
Nonoperating revenue (expense)		
Interest and investment revenue (expense) and gains (losses)	5,282,172	(397,838)
Change in net assets	6,386,175	1,592,241
Net assets, beginning of year	14,360,432	12,768,191
Net assets, end of year	$ 20,746,607	$ 14,360,432

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

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2010 and 2009

	2010	2009
Cash Flows From Operating Activities		
Premiums collected	$ 6,976,414	$ 14,533,629
Losses and loss adjustment expenses paid	(7,751,619)	(9,126,716)
Underwriting expenses paid	(467,830)	(6,829,083)
Miscellaneous payments	(539,477)	(42,107)
Net cash used in operating activities	(1,782,512)	(1,464,277)
Cash Flows From Investing Activities		
Purchases of investments	(85,915,983)	(201,263,240)
Proceeds from the sale of investments	88,396,768	203,313,996
Issuance of surplus note	(8,000,000)	-
Interest and dividends received	1,910,424	1,736,767
Net cash (used in)/provided by investing activities	(3,608,791)	3,787,523
Net change in cash and cash equivalents during the year	(5,391,303)	2,323,246
Cash and cash equivalents at beginning of year	10,382,823	8,059,577
Cash and cash equivalents at end of year	$ 4,991,520	$ 10,382,823

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

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

STATEMENTS OF CASH FLOWS - CONTINUED

For the Years Ended June 30, 2010 and 2009

	2010	2009
Reconciliation of operating income to net cash used in operating activities:		
Operating income	$ 1,104,003	$ 1,990,079
Adjustments to reconcile operating income to net cash used in operating activities:		
Depreciation	7,164	7,164
Provision for doubtful accounts	(1,880)	-
Changes in:		
Accounts receivable	(89,900)	(93,975)
Reinsurance receivable	(194,109)	(18,364)
Receivable from related entity	670,696	-
Other assets	(314,059)	267,036
Unpaid losses and loss adjustment expenses	(1,375,861)	(1,504,947)
Accounts payable	(286,291)	84,117
Reinsurance payable	-	(87,446)
Payable to related entity	3,626,055	(2,231,892)
Advance premiums	(4,928,330)	123,951
Net cash used in operating activities	$ (1,782,512)	$ (1,464,277)

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

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Organization

Effective July 1, 1978, the Kentucky Association of Counties (KACo) and the Kentucky League of Cities, Inc. (KLC) (formerly Kentucky League of Cities) formed the KACo-KLC Self-Insurance Fund (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. On 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 Statutes. 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 coverage's are written on an occurrence basis. Participation in the Trust included 415 and 435 members as of June 30, 2010 and 2009, 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 workers' compensation 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 costs 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.

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – 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 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 Trust uses the segmented time distribution method to measure interest rate risk.

Basis of Presentation

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 Trust has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Propriety Funds and other Governmental Entities that Use Proprietary Fund Accounting*. Therefore, the Trust 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.

Use of Estimates

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

Investment Securities

Investment securities consist of fixed maturity debt and equity securities that the Trust 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.

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Cash and Cash Equivalents

Cash and cash equivalents consist principally of money market fund investments. For purposes 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 practices 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 collectibility is doubtful.

Equipment

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

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

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% for both 2010 and 2009. Discounting reduced the liability by $5,677,163 and $5,682,034 as of June 30, 2010 and 2009, respectively. The effect of discounting on the provision for losses and loss adjustment expenses was an increase of $4,871 and $395,624 in 2010 and 2009, respectively.

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Net Assets

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 assets.

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 KLCWCT. No refunds were issued during 2010 or 2009.

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 the Internal Revenue Code Section 115, which pertains to instrumentalities of state and local governments.

NOTE B - 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, 2010 and 2009 are as follows:

	2010	2009
Cash and cash equivalents	$ 4,142,762	$ 1,599,416
Money market mutual funds and uninvested cash	848,758	8,783,407
Deposits and investments classified as cash and cash equivalents	4,991,520	10,382,823
U.S. Treasury notes and bonds	-	322,773
Corporate bonds	920,719	5,932,296
Municipal securities	27,286,981	13,184,154
U.S. government agency obligations	2,953,366	9,469,187
Equity securities	1,047,848	1,482,595
Equity mutual funds	7,480,191	3,420,281
Bond mutual funds	2,731,002	7,670,446
Investments classified as investment securities	42,420,107	41,481,732
Total deposits and investments	$ 47,411,627	$ 51,864,555

NOTE B - DEPOSITS AND INVESTMENTS - CONTINUED

As of June 30, 2010, the Trust had the following investment maturities:

	Investment Maturities (In Years)			
	Less than 1	1-5	6-10	More than 10
Corporate bonds	$ -	$ -	$ 920,719	$ -
Municipal securities	1,605,722	8,664,447	8,107,877	8,908,935
U.S. government agency obligations	-	-	2,191,385	761,981
Total maturities	$ 1,605,722	$ 8,664,447	$ 11,219,981	$ 9,670,916

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, 2010 and 2009:

	2010	2009
Interest and dividend income	$ 1,923,761	$ 1,675,338
Realized loss on sales of securities	912,813	(1,337,701)
Unrealized loss on securities	2,445,598	(735,475)
	$ 5,282,172	$ (397,838)

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 statute 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, U.S.

NOTE B - DEPOSITS AND INVESTMENTS - CONTINUED

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 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 who is insured by the Federal Deposit 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, 2010, the Trust was invested in the following government agency bonds: Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association and Government National Mortgage. All of these bonds had AAA ratings. The Trust also invested in money market funds with a rating of AAA. Additional investments include U.S. Treasury notes and bonds, all with a AAA rating, and corporate bonds which ranged in ratings from AA1 to AA.

Custodial Credit Risk - Deposits

As of November 26, 2008, the Federal Deposit Insurance Corporation (FDIC) created the Transaction Account Guarantee Program. Under this program, through December 31, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. As of June 30, 2010 and 2009, the Trust's financial institution is participating in this program and therefore the Trust has no deposits in excess of federally insured limits. The Trust also has a collateral agreement with one of its banks in the amount of $4,000,000, which covers the assets held at the bank of all of KLC, Inc.'s entities. This collateral consists of U.S. government securities whose fair values exceed the amount of the bank balance of the deposit and are held by an independent third-party agent of KLC, Inc. in KLC, Inc.'s name. Cash equivalents include investments in a money market fund that are not federally insured.

NOTE C - REINSURANCE COVERAGE

Beginning in 2008, the Trust purchased reinsurance coverage from ACE USA, an "A" rated insurer by A.M. Best and Company, for claims paid in excess of $750,000 but less than $2,000,000. As part of this agreement, the Trust also purchased a $250,000 corridor of aggregate reinsurance on claims in excess of $750,000. Under this contract, the aggregate corridor threshold must be met before any specific reinsurance would take effect. For claims in excess of $2,000,000, the Trust purchased reinsurance coverage from ACE USA. For 2009 and 2008, employer's liability loss limitations are $4,000,000 (retention of $750,000 plus $3,250,000 of reinsurance).

Although the purchase of reinsurance coverage does not discharge the Trust 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 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 [redacted] and [redacted] for the years ended June 30, 2010 and 2009, respectively. Reinsurance recoveries on paid claims during 2010 and 2009 were [redacted] and [redacted] 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 [redacted] and [redacted] in 2010 and 2009, respectively.

NOTE D - 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, 2010 and 2009 is summarized as follows:

	2010	2009
Net unpaid losses and loss adjustment expenses, beginning of year	$[redacted]	$[redacted]
Incurred losses and loss adjustment expenses:		
Provision for insured events of the current year	[redacted]	[redacted]
Decrease in provision for insured events of prior years	[redacted]	[redacted]
Total incurred losses and loss adjustment expenses	[redacted]	[redacted]
Paid losses and loss adjustment expenses:		
Attributable to insured events of the current year	[redacted]	[redacted]
Attributable to insured events of prior years	[redacted]	[redacted]
Total payments	[redacted]	[redacted]
Net unpaid losses and loss adjustment expenses, end of year	$[redacted]	$[redacted]

A decrease in the provision for insured events of prior years signifies that the Trust expects lower than anticipated ultimate losses in the final disposition of claims.

NOTE E - RELATED PARTY TRANSACTIONS

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 $1,924,289 and $2,288,144 for the years ended June 30, 2010 and 2009, respectively.

The Trust participates in a marketing agreement with Kentucky League of Cities Insurance Services, Inc. (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 $256,144 and $357,301 for the years ended June 30, 2010 and 2009, respectively.

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

NOTE F – SURPLUS NOTE RECEIVABLE

In 2010, the Kentucky Department of Insurance (DOI) approved the opportunity for the Trust to administer the KSBIT program, provided that the Trust issue an $8 million dollar surplus note receivable in exchange for an investment in KSBIT. The amount of the surplus note is classified as restricted 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 KSBIT gains increased financial stability the entire $8 million dollars will be recovered either through repayment or alternate plan as deemed appropriate by the DOI.

NOTE G - LETTER OF CREDIT

To satisfy requirements of the Department of Workers' Claims 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, 2010, renewable annually. As of June 30, 2010 and 2009, no amounts were outstanding under the letter of credit.

SUPPLEMENTARY INFORMATION

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST
Claims Development Information (*Unaudited*)
Years ended June 30, 2001 through 2010

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									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
(1) Earned premium revenue and net investment income:										
Earned	$ [redacted]	$ [redacted]	$ [redacted]	$ [redacted]	[redacted]	[redacted]	$ [redacted]	[redacted]	[redacted]	$ [redacted]
Ceded	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Net earned	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
(2) Unallocated expenses	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
(3) Estimated incurred claims and expenses, end of policy year:										
Incurred	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Ceded	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Net incurred	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
(4) Net paid (cumulative) as of:										
End of policy year	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
One year later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
Two years later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]		
Three years later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]			
Four years later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]				
Five years later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]					
Six years later	[redacted]	[redacted]	[redacted]	[redacted]						
Seven years later	[redacted]	[redacted]	[redacted]							
Eight years later	[redacted]	[redacted]								
Nine years later	[redacted]									
(5) Reestimated ceded claims and expenses	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
(6) Reestimated net incurred claims and expenses:										
End of policy year	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
One year later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
Two years later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]		
Three years later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]			
Four years later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]				
Five years later	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]					
Six years later	[redacted]	[redacted]	[redacted]	[redacted]						
Seven years later	[redacted]	[redacted]	[redacted]							
Eight years later	[redacted]	[redacted]								
Nine years later	[redacted]									
(7) Increase (decrease) in estimated net incurred claims and expenses from the end of policy year	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

See accompanying independent auditor's report

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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

To the Board of Trustees of
Kentucky League of Cities Workers' Compensation Trust

We have audited the financial statements of Kentucky League of Cities Workers' Compensation Trust as of and for the year ended June 30, 2010, and have issued our report thereon dated October 27, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Trust's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Trust's internal control over financial reporting.

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.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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Compliance and Other Matters

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

We noted certain matters that we reported to the management in a separate letter dated October 27, 2010.

This report is intended solely for the information of the Board of Trustees, management, and the Kentucky Department of Insurance and is not intended to be and should not be used by anyone other than these specified parties.

Mountjoy Chilton Medley LLP

Lexington, Kentucky
October 27, 2010