Kentucky League of Cities Unemployment Compensation Reimbursement Trust

Financial Statements

Years Ended June 30, 2010 and 2009

Kentucky League of Cities Unemployment Compensation Reimbursement 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 Unemployment Compensation Reimbursement Trust

We have audited the accompanying statements of net assets of Kentucky League of Cities Unemployment Compensation Reimbursement 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky League of Cities Unemployment Compensation Reimbursement 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 May 25, 2011 on our consideration of Kentucky League of Cities Unemployment Compensation Reimbursement 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 audits.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 4 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit 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.

Mountjoy Chilton Medley LLP

Lexington, Kentucky
May 25, 2011

Kentucky League of Cities Unemployment Compensation Reimbursement Trust

Management Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky League of Cities Unemployment Compensation Reimbursement 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 5.

Using This Annual Report

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

Statements of Net Assets

Table 1 shows all of the assets and liabilities of the Trust and is presented on the accrual basis. Total net assets decreased $624,184 for the current fiscal year compared to a $235,968 decrease during the prior fiscal year. The current fiscal year decrease in net assets is primarily due to the fact that the national unemployment climate has changed over the past year. Unemployment benefits have been extended, creating unexpected and unfunded mandates for cities/agencies. In addition, the state of Kentucky has recently started charging interest for employee benefits paid on behalf of the members. The interest is calculated from the date of benefit payment to the date of the quarterly bill KLC receives to reimburse. All of these unexpected changes have added substantial costs to the program. Please see additional information included under Statements of Revenues, Expenses, and Changes in Net Assets.

Table 1
Net Assets

	June 30, 2010	June 30, 2009
Cash and investments	$ 4,669,932	$ 4,889,753
Other assets	489,432	584,698
Total assets	$ 5,159,364	$ 5,474,451
Claims payable	$ 660,405	$ 454,601
Other liabilities	226,375	123,082
Total liabilities	886,780	577,683
Net assets	$ 4,272,584	$ 4,896,768

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. Interest and investment income decreased $46,248. Benefits payments increased 51% for the current fiscal year as compared to an 11% increase in the prior fiscal year.

Table 2
Changes in Net Assets

	Year Ended June 30, 2010	Year Ended June 30, 2009
Participant deposits	$ 1,480,447	$ 1,210,867
Investment and other revenue, net of investment expenses	32,996	79,244
Total revenues	1,513,443	1,290,111
Benefit payments	1,865,508	1,234,503
Operating expenses	184,755	174,494
Total expenses	2,050,263	1,408,997
Return of net assets to cancelled members	(1,203)	(53,959)
Trust distributions	(86,161)	(63,123)
Change in net assets	$ (624,184)	$ (235,968)

Description of Current and Expected Conditions

Benefits payments are expected to continue to remain consistent next year due to the continued budget pressures faced by the members. Investment income in expected to decrease because of market devaluations on fixed income securities and the necessity to liquidate investments prior to maturity to fund benefit payments. The administrative fee received by KLC was reduced 14% for the upcoming year to help offset a portion of the increased benefit payments. Each member’s benefit payments only affect their own individual balances. Investment income is allocated to each member with a positive balance proportionate to their balance.

Contacting the Trust's Financial Management

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

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Statements of Net Assets
June 30, 2010 and 2009

	2010	2009
Assets		
Cash and cash equivalents	$ 4,290,576	$ 4,889,753
Investment securities, at fair value	379,356	-
Accrued investment income	3,531	1,167
Receivable from related entity	-	126,072
Receivable from participants, net of allowance of $3,280 as of June 30, 2010 and 2009	485,901	454,366
Other assets	-	3,093
Total assets	$ 5,159,364	$ 5,474,451
Liabilities and net assets		
Payable to Commonwealth of Kentucky	$ 660,405	$ 454,601
Payable to related entity	134,214	-
Accrued trust distributions	86,161	117,082
Other liabilities	6,000	6,000
Total liabilities	886,780	577,683
Net assets	4,272,584	4,896,768
Total liabilities and net assets	$ 5,159,364	$ 5,474,451

See accompanying notes.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Statements of Revenues, Expense, and Changes in Net Assets
Years Ended June 30, 2010 and 2009

	2010	2009
Operating revenue		
Participant deposits	$ 1,030,531	$ 932,603
Reimbursement of participants' deficit balances	449,916	278,264
Total operating revenues	1,480,447	1,210,867
Operating expenses		
Benefit payments	1,865,508	1,234,503
Other operating expenses	184,755	174,494
Total operating expense	2,050,263	1,408,997
Operating loss	(569,816)	(198,130)
Nonoperating revenue		
Interest and investment revenue and gains, net of investment expenses	32,996	79,244
Loss before transfers and distributions	(536,820)	(118,886)
Return of net assets to cancelled members	(1,203)	(53,959)
Trust distributions	(86,161)	(63,123)
Change in net assets	(624,184)	(235,968)
Net assets, beginning of year	4,896,768	5,132,736
Net assets, end of year	$ 4,272,584	$ 4,896,768

See accompanying notes.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Statements of Cash Flows
Years Ended June 30, 2010 and 2009

	2010	2009
Cash Flows From Operating Activities		
Premiums collected	$ 1,448,912	$ 1,045,318
Benefits paid	(1,659,701)	(1,015,748)
Other payments	78,621	11,335
Net cash (used in) provided by operating activities	(132,168)	40,905
Cash Flows From Capital and Related Financing Activities		
Trust distributions paid and return of net assets to cancelled members	(118,285)	(76,485)
Cash Flows From Investing Activities		
Purchase of investments	(372,248)	-
Interest and dividends received	23,524	87,268
Net cash (used in) provided by investing activities	(348,724)	87,268
Net change in cash and cash equivalents during the year	(599,177)	51,688
Cash and cash equivalents at beginning of year	4,889,753	4,838,065
Cash and cash equivalents at end of year	$ 4,290,576	$ 4,889,753

See accompanying notes.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Statements of Cash Flows - Continued
Years Ended June 30, 2010 and 2009

	2010	2009
Reconciliation of operating loss to net cash (used in) provided by operating activities:		
Operating loss	$ (569,816)	$ (198,130)
Adjustments to reconcile operating loss to net cash (used in) provided by operating activities:		
Changes in:		
Receivable from/payable to participants	(31,535)	(165,549)
Other assets	3,093	(1,070)
Receivable from/payable to related entity	260,286	186,899
Payable to Commonwealth of Kentucky	205,804	218,755
Net cash (used in) provided by operating activities	$ (132,168)	$ 40,905

See accompanying notes.

Note A – Nature of Organization and Operations

The Kentucky League of Cities Unemployment Compensation Reimbursement Trust (the Trust) was organized as a nonprofit trust by the Kentucky League of Cities, Inc. (KLC), effective January 1, 1979. The Trust was established as a service to KLC members and their related agencies who elect coverage (Participants) under the Kentucky Unemployment Compensation Amendments of 1976 and KRS 341.277. These statutes provide that governmental entities, in lieu of making contributions to the Kentucky Unemployment Compensation Fund, can elect to reimburse the Commonwealth of Kentucky (the Commonwealth) for all benefits paid to workers for compensable weeks of unemployment.

The Participants make quarterly deposits to the Trust based upon deposit rates determined by an actuary and approved by the Board of Trustees. Benefits paid by the Commonwealth are reimbursed by the Trust and charged to each participant's account. The Agreement of Participation provides that each participant is responsible for all benefits paid to its employees, and each participant is required to make additional deposits to the Trust if its deposits plus allocated investment income are less than benefits and allocated expenses charged to its account. Thus, the Trust assumes no liability for participant deficit balances, as it operates as a pool of self-insured members rather than as a group self-insurer. As of June 30, 2010 and 2009, participation in the Trust included 316 and 317 members, respectively.

Following is a description of the most significant risks facing the Trust 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 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 that owe the insurer money will not pay. The Trust minimizes this risk by adhering to a conservative investment strategy, by maintaining credit and collection policies, and by providing an allowance for any amounts deemed uncollectible.

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.

Note B – Summary of Significant Accounting Policies

1. 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 Trust has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary 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.

2. 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.

3. Investment Securities

Investment securities consist of fixed income mutual funds, bonds, and other obligations of the U.S. Treasury and other corporations of the U.S. Government and are held by bank-administered trust funds. Investments are stated at fair value based 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 nonoperating 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 Trust considers all short-term investments with original maturities of three months or less to be cash equivalents.

Note B – Summary of Significant Accounting Policies (Continued)

5. Payable to Commonwealth of Kentucky

The liability for unemployment benefits payable to the Commonwealth represents quarterly benefits paid by the Commonwealth during the year that were reimbursed by the Trust subsequent to year end. The Trust does not recognize any liability for future benefits that may become payable relating to unemployment prior to year end, since each participant is ultimately liable for benefits paid to its employees.

6. Participant Accounts

Investment income, net of investment expenses, is allocated quarterly to participants based upon their pro rata share of the total net assets at the beginning of that quarter.

Operating expenses are allocated at the end of the year based upon the percentage of each participant's number of employees to the total number of employees for all participants.

7. 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.

8. Subsequent Events

Subsequent events for the Trust have been considered through the date of the Independent Auditor’s Report which represents the date the financial statements were available to be issued.

Note C – 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
Deposits and investments classified as cash and cash equivalents	$ 4,290,576	$ 4,889,753
U.S. government agency obligations	152,859	-
Corporate bonds	125,911	-
Fixed income equity mutual funds	100,586	-
Investments classified as investment securities	379,356	-
Total deposits and investments	$ 4,669,932	$ 4,889,753

Note C – 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
U.S. government agency obligations	$ -	$ -	$ 152,859	$ -
Corporate bonds	-	-	125,911	-
Total maturities	$ -	$ -	$ 278,770	$ -

Interest and investment income is comprised of the following for the years ended June 30, 2010 and 2009:

	2010	2009
Interest and dividend income, net of investment expenses	$ 25,888	$ 79,244
Realized gain on sales of securities	7,108	-
	$ 32,996	$ 79,244

Credit Risk

As of June 30, 2010 and 2009, more than 5% of the Trust's investments are in money market government mutual funds. This investment represented 92% and 100% of the Trust's total investments as of June 30, 2010 and 2009 respectively.

As of June 30, 2010, the Trust was invested in a Federal Home Loan Bank government agency bond with an AAA rating and corporate bonds which ranged in ratings from A- to AA+.

Note D – Receivables from Participants

Amounts receivable from participants consist of the following as of June 30, 2010 and 2009:

	2010	2009
Deposits for the three-month period ended June 30	$ 259,534	$ 236,466
Deficit balance reimbursements for the three-month period ended June 30	229,647	221,180
Less allowance for doubtful accounts	(3,280)	(3,280)
Total receivable from participants	$ 485,901	$ 454,366

The Agreement of Participation authorizes the Board of Trustees to require additional deposits from individual participants should their account reflect a deficit balance due to unfavorable experience or should the Trust become financially incapable of meeting its payment obligations. Deficit balances are billed to the participants quarterly, with reimbursements due within 30 days of notification.

Note E – Participant Deposits

Participants deposit to the Trust a percentage of the first $6,000 in annual wages paid to each of their covered employees. The percentages range from 0% to 13.39% and are based upon the participants' past experience. To facilitate participants' quarterly reporting to the Trust, the current board-approved formula adjusts the annual deposit rate to allow quarterly calculations on gross wages.

Note F – Service Bureau

The Trust has contracted with Talx, Inc. for unemployment compensation claims management services. Notification of payments due are submitted by the Commonwealth to Talx, Inc. who reviews the claims for validity and initiates a protest if applicable. Claims approved for payment by Talx, Inc. are then reported to the Trust and charged to the respective participant's account. For the year ended June 30, 2010, the fee for this service was $10,130 per quarter, subject to a 3% increase each January 1st. This fee is charged to the participants' accounts in equal quarterly installments. Service bureau fees were $41,126 and $39,928 for years ended June 30, 2010 and 2009, respectively.

Note G – Related Party Transactions

During the years ended June 30, 2010 and 2009, KLC charged each Trust participant an administrative fee of $7.00 per average full-time equivalent employee. The annual fee is charged to the participants' accounts in equal quarterly installments. The expense incurred by the Trust for this fee was $134,047 and $127,909 for the years ended June 30, 2010 and 2009, respectively.

All of the Trust's unemployment and administrative expenses and all of the Trust's members' premiums paid are paid from and deposited to KLC's operating account, respectively. Each month the Trust determines the amount of reimbursement due to or from KLC, and subsequently funds are transferred to satisfy the balance. The amount (payable to) receivable from KLC for unemployment and administrative expenses as of June 30, 2010 and 2009 was $(134,214) and$126,072, respectively.

Included in the interest and investment revenue balance is interest revenue from a line of credit with KLC Premium Finance Company. As of June 30, 2010 and 2009, interest revenue from the line of credit was $29,805 and $61,706, respectively. The interest rate is set annually by the Board of Directors, with no defined repayment schedule. There were no amounts outstanding at June 30, 2010 and 2009 under this line of credit.

Note H – Trust Distributions

For the years ended June 30, 2010 and 2009, due to an excess of net assets as determined by an actuarial study, the Board of Trustees authorized Trust distributions to participants of up to $124,950 and $131,551, respectively. Actual trust distributions recognized were $86,161 and $63,123, respectively. The Trust also authorized the return of $1,203 and $53,959 to members who elected to withdraw from the Trust during the years ended June 30, 2010 and 2009, respectively.

Note I – Other Operating Expenses

Other operating expenses consisted of the following for the years ended June 30, 2010 and 2009:

	2010	2009
Service bureau fees	$ 41,126	$ 39,928
KLC administrative fees	134,047	127,909
Professional fees	6,000	6,000
Other expenses	3,582	657
	$ 184,755	$ 174,494

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 Unemployment Compensation Reimbursement Trust

We have audited the financial statements of Kentucky League of Cities Unemployment Compensation Reimbursement Trust as of and for the year ended June 30, 2010, and have issued our report thereon dated May 25, 2011. 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 would not necessarily identify all deficiencies in internal control 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.

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 their 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*.

This report is intended solely for the information and use 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
May 25, 2011