KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

FINANCIAL STATEMENTS AND SUPPLEMENTAL INFORMATION

Years Ended June 30, 2010 and 2009

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

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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 Insurance Services Association

We have audited the accompanying statements of net assets of Kentucky League of Cities Insurance Services Association (KLCIS) 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 KLCIS' 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 Insurance Services Association 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 KLCIS' 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.

The Management Discussion and Analysis on pages 3 - 4 and the claims development information included on pages 20 - 21 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.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on pages 18 - 19 is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Mountjoy Chilton Medley LLP

Lexington, Kentucky
October 27, 2010

Management Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky League of Cities Insurance Services Association (KLCIS) provides an overview of KLCIS'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, notes to the financial statements, and supplemental information.

Statements of Net Assets

Table 1 shows all the assets and liabilities of KLCIS and is presented on the accrual basis. Total net assets increased $1,159,750 for the current fiscal year as compared to a ($2,857,122) decrease during the prior fiscal year. The current year's increase was largely attributable to market value appreciation on investments held to maturity and efficient claims management, while the prior year's decrease in income stems mostly from market value declines on investment holdings due to an uncertain economic climate.

Table 1
Net Assets

	June 30, 2010	June 30, 2009
Cash and investments	$ 28,994,211	$ 37,834,765
Capital and other assets	9,167,257	7,989,345
Total assets	38,161,468	45,824,110
Unpaid losses and loss adjustment expenses	25,234,824	25,523,602
Other liabilities	4,496,587	13,030,201
Total liabilities	29,731,411	38,553,803
Total net assets	$ 8,430,057	$ 7,270,307

Statements of Revenues, Expenses and Changes in Net Assets

Table 2 shows the revenue and expenses of KLCIS and is also presented on the accrual basis. Net earned premium revenue has decreased $677,722 or 3.3% from the prior fiscal year. General administrative expenses increased 1.7% as compared to the 3.3% decrease in net earned premiums. The "Legacy Claims Program", was very successful and helped give rise to a $2,514,734 or 18.2% decrease in loss and loss adjustment expense compared to the prior fiscal year. The program identified claims of two or more years of age that had an opportunity to settle for a lump sum payment (less than currently reserved) amount, as opposed to enduring long and litigious processes. The net result of this program on the current fiscal year was approximately 100 older claims were settled with net overall reserve takedowns of approximately $850,000. Economic conditions helped fuel this program and bring about the reduction in loss and loss adjustment expense over the previous year.

Table 2
Changes in Net Assets

	Year Ended June 30, 2010	Year Ended June 30, 2009
Net premiums earned	$ 19,732,423	$ 20,410,145
Investment and other revenue (expense) and gains (losses)	1,724,814	(606,440)
Total revenues	21,457,237	19,803,705
Losses and loss adjustment expenses	11,332,450	13,847,184
General administrative expenses	8,965,037	8,813,643
Total expenses	20,297,487	22,660,827
Total change in net assets	$ 1,159,750	$ (2,857,122)

Description of Current Expected Conditions

Looking ahead, KLCIS hopes to continue to benefit from a rebounding and more stable market, where its investments have an opportunity to yield greater, more positive returns. During the current year, KLCIS did an analysis of its claim experience, as relates to claims that have pierced retention levels over the previous ten years. The general consensus, given the same loss experience patterns, was that both the Liability and Property Trusts could retain greater surplus by raising their specific SIR levels. Accordingly, the Liability Trust increased its specific retention from $500,000 to $750,000 for the upcoming year and the Property Trust increased its specific retention from $250,000 to $350,000 for the upcoming year. The analysis predicted reinsurance premium savings would amount to more than the additional amounts retained, assuming the same frequency and severity loss patterns, as previously experienced.

Contacting the Organization's Financial Management

This financial report is designed to provide a general overview of 2010's finances and to show the KLCIS' 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 INSURANCE SERVICES ASSOCIATION

STATEMENTS OF NET ASSETS

June 30, 2010 and 2009

	2010	2009
ASSETS		
Investment securities, at fair value	$ 26,949,632	$ 29,354,484
Cash and cash equivalents	2,044,579	8,480,281
Accounts receivable (net of allowance for doubtful accounts of $29,964 and $30,000 in 2010 and 2009, respectively)	261,104	304,249
Reinsurance receivable	1,061,996	976,381
Receivable from related entity	6,220,576	5,080,228
Accrued investment income	244,308	315,120
Membership in NLC Mutual Insurance Company	620,037	620,037
Property and equipment (net of accumulated depreciation of $1,024,214 and $987,019 for 2010 and 2009, respectively)	124,039	207,687
Prepaid expenses	635,197	485,643
Total assets	$ 38,161,468	$ 45,824,110
LIABILITIES AND NET ASSETS		
Unpaid losses and loss adjustment expenses:		
Reported claims	$ 10,521,796	$ 11,696,544
Incurred but not reported claims	13,838,625	12,840,029
Unallocated loss adjustment expenses	874,403	987,029
Total unpaid losses and loss adjustment expenses	25,234,824	25,523,602
Accounts payable	348,847	229,593
Advance premiums	4,147,740	12,800,608
Total liabilities	29,731,411	38,553,803
Net Assets	8,430,057	7,270,307
Total liabilities and net assets	$ 38,161,468	$ 45,824,110

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

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

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	$ 19,732,423	$ 20,410,145
Operating expenses		
Losses and loss adjustment expenses	11,332,450	13,847,184
Commission expense	2,918,788	3,021,518
Claims administration expense	1,064,104	923,299
Loss prevention expenses	164,659	222,694
Professional fees	458,388	284,171
KLC administrative fees	3,795,712	3,801,856
Other expenses	563,386	560,105
Total operating expenses	20,297,487	22,660,827
Operating loss	(565,064)	(2,250,682)
Nonoperating revenue (expense)		
Interest and investment revenue (expense) and gains (losses)	1,713,833	(652,298)
Other income	10,981	45,858
Total nonoperating revenue (expense)	1,724,814	(606,440)
Change in net assets	1,159,750	(2,857,122)
Net assets, beginning of year	7,270,307	10,127,429
Net assets, end of year	$ 8,430,057	$ 7,270,307

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

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2010 and 2009

	2010	2009
Cash Flows From Operating Activities		
Premiums collected	$ 11,122,700	$ 21,223,313
Losses and loss adjustment expenses paid	(11,649,650)	(10,992,714)
Underwriting expenses paid	(9,736,950)	(10,296,379)
Other payments	(389,278)	(154,043)
Net cash used in operating activities	(10,653,178)	(219,823)
Cash Flows From Investing Activities		
Purchases of investments	(41,033,916)	(52,398,849)
Proceeds from maturity of investments	6,273,217	5,836,250
Proceeds from sale of investments	37,707,131	43,967,952
Interest and dividends received	1,243,063	1,507,466
Net cash provided by/(used in) investing activities	4,189,495	(1,087,181)
Cash Flows From Capital and Related Financing Activities		
Proceeds from sale of capial assets	17,000	-
Other	10,981	45,858
Capital expenditures	-	(148,485)
Net cash provided by/(used in) capital and related financing activities	27,981	(102,627)
Net change in cash and cash equivalents during the year	(6,435,702)	(1,409,631)
Cash and cash equivalents at beginning of year	8,480,281	9,889,912
Cash and cash equivalents at end of year	$ 2,044,579	$ 8,480,281

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

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2010 and 2009

	2010	2009
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$ (565,064)	$ (2,250,682)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	64,293	53,671
Loss on disposal of equipment	2,357	14,240
Provision for doubtful accounts	(36)	996
Changes in:		
Accounts receivable	43,181	(246,842)
Reinsurance receivable	(85,615)	(119,925)
Receivable from related entity	(1,140,348)	(1,730,780)
Prepaid expenses	(149,554)	402,689
Unpaid losses and loss adjustment expenses	(288,778)	2,854,470
Accounts payable	119,254	116,170
Reinsurance payable	-	(372,844)
Advance premiums	(8,652,868)	1,059,014
Net cash used in operating activities	$ (10,653,178)	$ (219,823)

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

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2010 and 2009

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

Nature of Organization

Kentucky Municipal Risk Management Association was established in April 1987 under the authorization of the Kentucky Interlocal Cooperation Act of the Kentucky Revised Statutes for the purpose of creating and operating various self-insurance, insurance and investment trusts. It is an unincorporated, nonprofit association voluntarily established by the participating cities, urban-county governments and related public agencies and political subdivisions within the Commonwealth of Kentucky. During 2003, the Association changed its name to Kentucky League of Cities Insurance Services Association (KLCIS).

KLCIS 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. KLCIS' general objectives are to formulate, develop and administer, on behalf of the member political subdivisions, a program of insurance and to obtain lower costs for that coverage. KLCIS offers general, public official, law enforcement and auto liability coverage as well as auto physical damage coverage for participating municipalities (the liability pool). All coverages are written on an occurrence basis. In addition, KLCIS operates a property insurance program for participating municipalities (the property pool). Participation in the liability and property pools included 414 and 363 members, respectively, as of June 30, 2010.

Following is a description of the most significant risks facing property/casualty insurers and how KLCIS 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. KLCIS 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. KLCIS 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.

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. KLCIS 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. KLCIS uses the segmented time distribution method to measure interest rate risk.

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

Geographic Risk:

Geographic risk is the risk that catastrophic losses will occur in one concentrated area where KLCIS does business. KLCIS writes all of its business in Kentucky. KLCIS mitigates this risk by adhering to specified underwriting practices and by obtaining catastrophic reinsurance coverage.

Basis of Presentation

KLCIS 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.

KLCIS 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, KLCIS has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting.* Therefore, KLCIS 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 KLCIS 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, under 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, KLCIS 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.

Property and Equipment

Property and equipment consists of leasehold improvements, furniture and fixtures, computer equipment and related software. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. For the years ended June 30, 2010 and 2009, depreciation expense amounted to $64,293 and $53,671, respectively.

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.

Unpaid Losses and Loss Adjustment Expenses

Unpaid losses and loss adjustment expenses are based on estimates of the ultimate cost of claims (including future claim adjustment expenses) 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 costs depend 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 reflect 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 2010 and 2009. Discounting reduced the liability by $1,450,985 and $1,420,899 as of June 30, 2010 and 2009, respectively. The effect of discounting on the provision for losses and loss adjustment expenses was a decrease of $30,086 in 2010 and $196,897 in 2009.

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

Net Assets

KLCIS' Board of Trustees may, at its discretion, refund to members the savings, if any, resulting from operations of KLCIS in the form of dividends or reduced premiums. The amount of any future dividends or reductions in premiums is dependent on KLCIS' ultimate liability for claims incurred and, accordingly, the amount may differ from net assets.

KLCIS has received initial capital contributions from members to provide start-up surplus. Capital contributions were primarily determined based on a percentage of current annual premiums. Capital contributions are refundable only at the discretion of the Board of Trustees.

In the event of adverse loss experience, KLCIS 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. There have been no assessments levied since the inception of KLCIS. No refunds were issued during 2010 or 2009.

Federal Income Taxes

The Internal Revenue Service has ruled that the income of KLCIS 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.

NOTE B - DEPOSITS AND INVESTMENTS

The composition of KLCIS' investment portfolio must meet certain criteria as set forth in the Kentucky Revised Statutes. Investments held by KLCIS as of June 30, 2010 and 2009 are as follows:

	2010	2009
Cash and cash equivalents	$ 306,565	$ (633,736)
Money market mutual funds	1,738,014	9,114,017
Deposits and investments classified as cash and cash equivalents	2,044,579	8,480,281
Certificates of deposit	296,658	596,881
Corporate bonds	5,782,303	7,153,509
Municipal bonds	5,058,294	3,086,794
U.S. government agency obligations	11,817,582	13,045,411
Equity mutual funds	1,377,111	1,887,463
Equity securities	2,617,684	3,584,426
Investments classified as investment securities	26,949,632	29,354,484
Total deposits and investments	$ 28,994,211	$ 37,834,765

NOTE B - DEPOSITS AND INVESTMENTS - CONTINUED

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

	Investment Maturities (in Years)			
	Less Than 1	1-5	6-10	More Than 10
Certificates of deposit	$ 296,658	$ -	$ -	$ -
Corporate bonds	1,502,173	2,874,560	1,005,570	400,000
Municipal bonds	1,335,027	2,807,917	915,350	-
U.S. government agency obligations	2,105,236	8,551,480	1,160,866	-
Total maturities	$ 5,239,094	$ 14,233,957	$ 3,081,786	$ 400,000

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

	2010	2009
Interest and dividend income	$ 1,070,935	$ 1,520,231
Realized losses on sales of securities	(204,518)	(1,080,549)
Unrealized gains (losses) on securities	847,416	(1,091,980)
	$ 1,713,833	$ (652,298)

Credit Risk

Pursuant to state law, no more than 20% of admitted assets may be invested in medium and lower grade investments; no more than 10% of admitted assets may be invested in lower grade securities; investments with a rating of 5 or 6 from a nationally recognized statistical rating organization (NRSRO) cannot exceed 3% of admitted assets; investments with a rating of 6 from a NRSRO cannot exceed 1% of admitted assets. KLCIS' internal investment policy does not allow the purchase of medium or lower grade investments; however, investments already owned may be retained when the rating drops from high grade to medium or lower grades.

State law and KLCIS' policy both state that total medium and lower grade investments issued, assumed, guaranteed, accepted or insured by any one organization (or as to asset back securities, any interest in a single asset or pool of assets) may not exceed 1% of admitted assets. KLCIS' policy further states that total medium grade holdings tied to a single source shall be limited to 1% of total assets. State law and KLCIS' policy both require that no more than 3% of admitted assets shall be invested in any single asset or, for asset backed securities, any single pool of assets.

State law requires that the total amount of equities held shall not exceed the greater of 25% of admitted assets or 100% of members' surplus. KLCIS' policy requires that the total amount of equities held shall not exceed the lesser of 25% of admitted assets or 50% of members' surplus at the time of purchase. KLCIS' policy also states that no single issuer shall comprise more than 10% of the market value of the investment managers' portfolio, excluding cash and cash equivalents. Finally, KLCIS' policy states that no holding shall represent 5% or more of the voting rights of the issuer.

NOTE B - DEPOSITS AND INVESTMENTS - CONTINUED

As of June 30, 2010, KLCIS was invested in the following government agency bonds: Federal Farm Credit Bank, Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association and Government National Mortgage Association. All of these bonds had AAA ratings. KLCIS also invested in corporate bonds which ranged in ratings from BAA1 to AAA. Additional investments included U.S. Treasury notes and bonds, bond mutual funds, and municipal bonds, all of which had AA1, AA2 or AAA ratings.

Custodial Credit Risk - Deposits

The bank balances of KLCIS' cash and cash equivalents with financial institutions are insured by the FDIC up to $100,000. In October 2008, the FDIC increased this insurance to $250,000, effective through December 31, 2013. KLCIS 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 the Kentucky League of Cities (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. As of June 30, 2010 and 2009, KLCIS had uninsured cash balances of approximately $972,000 and $504,000, respectively. Cash equivalents include investments in a money market fund that are not federally insured.

NOTE C - REINSURANCE COVERAGE

The Board of Trustees has authorized KLCIS' participation in NLC Mutual Insurance Company (NLC-MIC). NLC-MIC was organized for the purpose of providing reinsurance coverage to participating members of the National League of Cities. KLCIS was not required to make a capital contribution to NLC-MIC during 2010 and 2009. In order to reduce KLCIS' ultimate loss exposure arising from large losses in the liability pool, KLCIS purchases specific excess of loss reinsurance coverage for protection against losses in excess of $500,000 per occurrence.

For 2010 and 2009, KLCIS purchased reinsurance coverage for the liability pool from two reinsurance carriers rated "A+" (Superior) by A.M. Best and Company. KLCIS purchased a buffer layer of reinsurance, defined as $500,000 in excess of $500,000, as specific reinsurance coverage per occurrence from ACE USA (ACE). In addition to this coverage, KLCIS also purchased an excess reinsurance policy for specific coverage on claims $9,000,000 in excess of $1,000,000 from Munich Reinsurance America (Munich).

Reinsurance coverage for the property pool is purchased from various reinsurers, each of which has been assigned a rating of A (Excellent) by A.M. Best and Company. In addition to specific excess of loss reinsurance, the property pool also maintains aggregate reinsurance coverage. Policy limits vary based upon the type and amount of insured risk. Reinsurance premiums are based upon a percentage of direct property pool premium revenue or total insured value.

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

NOTE C - REINSURANCE COVERAGE - CONTINUED

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:

	Liability Pool		Property Pool	
	2010	2009	2010	2009
Net unpaid losses and loss adjustment expenses, beginning of year	[redacted]	[redacted]	$ [redacted]	$ [redacted]
Incurred losses and loss adjustment expenses:				
Provision for insured events of the current year	[redacted]	[redacted]	[redacted]	[redacted]
Increase (decrease) in provision for insured events of prior years	[redacted]	[redacted]	[redacted]	[redacted]
Total incurred losses and loss adjustment expenses	[redacted]	[redacted]	[redacted]	[redacted]
Payments:				
Losses and loss adjustment expenses attributable to insured events of the current year	[redacted]	[redacted]	[redacted]	[redacted]
Losses and loss adjustment expenses attributable to insured events of prior years	[redacted]	[redacted]	[redacted]	[redacted]
Total payments	[redacted]	[redacted]	[redacted]	[redacted]
Net unpaid losses and loss adjustment expenses, end of year	[redacted]	[redacted]	$ [redacted]	[redacted]

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

NOTE E - RELATED PARTY TRANSACTIONS

KLCIS was organized by the KLC, Inc. at the request of the state municipalities. KLC provides substantially all of KLCIS' 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 $3,795,712 and $3,801,856 for the years ended June 30, 2010 and 2009, respectively.

KLCIS participates in a marketing agreement with Kentucky League of Cities Insurance Services, Inc. (the Agency) which provides that KLCIS pay a commission for member accounts marketed or serviced by the Agency. Commission expense under the agreement was $821,956 and $872,279 for the years ended June 30, 2010 and 2009, respectively.

KLCIS' directors' and officers' insurance provides coverage for KLC board members. Also, certain trustees of KLCIS are directors for KLC.The Kentucky League of Cities serves as Administrator of KLCIS. A family member of the executive management of the Administrator is a partner in one of 15 law firms engaged as defense counsel by KLCIS. All firms selected as defense counsel are paid the same hourly rate.

NOTE F - COMMITMENTS AND CONTINGENCIES

KLCIS is the guarantor for an irrevocable standing letter of credit with a bank for a related party. The letter of credit permitted borrowings of $3.3 million as of June 30, 2010. As of June 30, 2010 and 2009, no amounts were outstanding under the letter of credit. The investments of KLCIS are used as collateral for the letter of credit.

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

SUPPLEMENTARY INFORMATION

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION
Statements of Net Assets Information
June 30, 2010 and 2009

	2010			2009		
Assets	Liability Pool	Property Pool	Total	Liability Pool	Property Pool	Total
Investment securities, at fair value	$ 26,949,632	$ -	$ 26,949,632	$ 29,354,484	$ -	$ 29,354,484
Cash and cash equivalents	2,044,579	-	2,044,579	8,480,281	-	8,480,281
Accounts receivable	148,399	112,705	261,104	126,352	177,897	304,249
Reinsurance receivable	79,069	982,927	1,061,996	14,656	961,725	976,381
Receivable from related entity	1,435,502	4,785,074	6,220,576	(1,490,307)	6,570,535	5,080,228
Accrued investment income	244,308	-	244,308	315,120	-	315,120
Membership in NLC Mutual Insurance Company	620,037	-	620,037	620,037	-	620,037
Property and equipment	120,873	3,166	124,039	203,114	4,573	207,687
Prepaid expenses	239,900	395,297	635,197	132,657	352,986	485,643
Total assets	$ 31,882,299	$ 6,279,169	$ 38,161,468	$ 37,756,394	$ 8,067,716	$ 45,824,110
Liabilities and Net Assets						
Unpaid losses and loss adjustment expenses:						
Reported claims	$ 10,020,709	$ 501,087	$ 10,521,796	$ 10,812,973	$ 883,571	$ 11,696,544
Incurred but not reported claims	13,629,466	209,159	13,838,625	12,688,191	151,838	12,840,029
Unallocated loss adjustment expenses	850,791	23,612	874,403	937,168	49,861	987,029
Accounts payable	231,263	117,584	348,847	165,852	63,741	229,593
Advance premiums	2,881,213	1,266,527	4,147,740	9,469,026	3,331,582	12,800,608
Total liabilities	27,613,442	2,117,969	29,731,411	34,073,210	4,480,593	38,553,803
Net Assets	4,268,857	4,161,200	8,430,057	3,683,184	3,587,123	7,270,307
Total liabilities and net assets	$ 31,882,299	$ 6,279,169	$ 38,161,468	$ 37,756,394	$ 8,067,716	$ 45,824,110

See accompanying independent auditor's report

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION
Statements of Revenues, Expenses and Change in Net Assets Information
June 30, 2010 and 2009

	2010			2009		
	Liability Pool	Property Pool	Total	Liability Pool	Property Pool	Total
Operating revenue						
Net premiums earned	$ 14,734,674	$ 4,997,749	$ 19,732,423	$ 15,152,405	$ 5,257,740	$ 20,410,145
Total operating revenues	14,734,674	4,997,749	19,732,423	15,152,405	5,257,740	20,410,145
Operating expenses						
Losses and loss adjustment expenses	9,458,511	1,873,939	11,332,450	11,866,754	1,980,430	13,847,184
Commission expense	1,799,627	1,119,161	2,918,788	1,900,265	1,121,253	3,021,518
Claims administration expense	832,214	231,890	1,064,104	787,696	135,603	923,299
Loss prevention expenses	164,206	453	164,659	206,586	16,108	222,694
Professional fees	133,929	324,459	458,388	100,274	183,897	284,171
KLC administrative fees	2,818,031	977,681	3,795,712	2,864,213	937,643	3,801,856
Other expenses	389,397	173,989	563,386	392,893	167,212	560,105
Total operating expenses	15,595,915	4,701,572	20,297,487	18,118,681	4,542,146	22,660,827
Operating income (loss)	(861,241)	296,177	(565,064)	(2,966,276)	715,594	(2,250,682)
Nonoperating revenue (expense):						
Interest and investment revenue (expense) and gains (losses)	1,438,143	275,690	1,713,833	(467,587)	(184,711)	(652,298)
Other income	8,771	2,210	10,981	44,137	1,721	45,858
Total nonoperating revenue (expense)	1,446,914	277,900	1,724,814	(423,450)	(182,990)	(606,440)
Change in net assets	585,673	574,077	1,159,750	(3,389,726)	532,604	(2,857,122)
Net assets, beginning of year	3,683,184	3,587,123	7,270,307	7,072,910	3,054,519	10,127,429
Net assets, end of year	$ 4,268,857	$ 4,161,200	$ 8,430,057	$ 3,683,184	$ 3,587,123	$ 7,270,307

See accompanying independent auditor's report

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION
Claims Development Information (*Unaudited*)
Years ended June 30, 2001 through 2010

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 the data for successive policy years.

	Liability 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

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Claims Development Information (*Unaudited*)

Years ended June 30, 2001 through 2010

	Property 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 description of lines (1) through (7) on previous page.

See accompanying independent auditor's report

Mountjoy
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Medley

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 Insurance Services Association

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