

**KENTUCKY LEAGUE OF CITIES, INC. AND  
SUBSIDIARIES**

**Consolidated Financial Statements**

*Years Ended June 30, 2015 and 2014  
with Report of Independent Auditors*

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## Report of Independent Auditors

Board of Directors  
Kentucky League of Cities, Inc. and Subsidiaries  
Lexington, Kentucky

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Kentucky League of Cities, Inc. and Subsidiaries (collectively, KLC) which comprise the consolidated statements of net position as of June 30, 2015 and 2014, and the related consolidated statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with the accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Board of Directors  
Kentucky League of Cities, Inc. and Subsidiaries  
Report of Independent Auditors, continued

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kentucky League of Cities, Inc. and Subsidiaries as of June 30, 2015 and 2014, and the changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## Emphasis of Matter

As discussed in Note 2 to the consolidated financial statements, effective July 1, 2014, KLC adopted Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions*. Our opinion is not modified with respect to this matter.

## Other Matters

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 - 6 and the Schedule of the Proportionate Share of the Net Pension Liability and Schedule of Contributions on pages 39 - 40 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 the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audits were conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise KLC's basic financial statements. The consolidating schedules on pages 33 - 38 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Board of Directors  
Kentucky League of Cities, Inc. and Subsidiaries  
Report of Independent Auditors, continued

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated September 22, 2015 on our consideration of KLC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering KLC's internal control over financial reporting and compliance.

*Dean Dotson Allen Ford, PLLC*

September 22, 2015  
Lexington, Kentucky

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Management's Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky League of Cities, Inc. and Subsidiaries (KLC or the Organization) provides an overview of the Organization's financial activity for the fiscal year ended June 30, 2015. It should be read in conjunction with the consolidated financial statements, which begin on page 7.

### Using this Annual Report

This report consists of a series of financial statements. The consolidated statements of net position on page 7 provide information about the Organization as a whole.

### Statements of Net Position

Table 1 shows all of the assets and liabilities of the Organization and is presented on the accrual basis. The total net position decreased in the current year due to the adoption of Governmental Accounting Standards Board (GASB) Statement No. 68 requiring the recording of KLC's long-term obligation for pension benefits. (See Note 2 for further details).

**Table 1**  
**Net Position**

	<u>2015</u>	<u>2014</u>
Current assets	\$ 11,480,004	\$ 10,475,163
Capital and other assets	<u>7,999,913</u>	<u>8,431,777</u>
Total assets	19,479,917	18,906,940
Deferred outflows of resources	<u>814,449</u>	<u>-</u>
Combined assets and deferred outflows of resources	20,294,366	18,906,940
Current liabilities	2,680,618	2,709,589
Long-term liabilities	3,630,654	3,970,167
Net pension liability	6,466,000	-
Deferred inflows of resources	<u>722,000</u>	<u>-</u>
Combined liabilities and deferred inflows of resources	<u>13,499,272</u>	<u>6,679,756</u>
Total net position	\$ <u>6,795,094</u>	\$ <u>12,227,184</u>

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

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

### Statements of Revenues, Expenses and Changes in Net Position

Table 2 shows all the revenues and expenses of the Organization and is also presented on the accrual basis. The administrative fees received for providing staffing and overhead to the KLC related entities (KLCFT, KBC, KBDC, KLCIS, KLCUCRT, KLCWCT, KSBIT) increased approximately \$254,000, due to the reimbursement of costs associated with bringing workers' compensation claims administration in-house. Nonoperating revenues decreased approximately \$371,000, due to a decline in investment gains. Total operating expenses increased approximately \$158,000 from the prior year primarily due to increases in salaries, benefits and other administrative expenses.

Table 2  
Revenues, Expenses and Changes in Net Position

	<u>2015</u>	<u>2014</u>
Operating revenue:		
Administrative fees	\$ 7,142,682	\$ 6,888,715
Commissions	2,688,813	2,711,789
Member dues	492,224	465,638
Member meeting and training income	358,100	327,119
Premium finance revenue	176,533	169,420
Other	309,416	256,175
Publication income	<u>23,822</u>	<u>5,560</u>
Total operating revenue	11,191,590	10,824,416
Operating expenses:		
Administrative and general	(3,602,182)	(4,110,406)
Legislative services	(1,463,728)	(1,378,477)
Member financial services	(262,321)	(189,476)
Member insurance services	(5,369,742)	(4,926,802)
Member meeting and training services	<u>(246,410)</u>	<u>(180,876)</u>
Total operating expenses	(10,944,383)	(10,786,037)
Nonoperating revenue, net	<u>990,703</u>	<u>1,361,425</u>
Change in net position	\$ <u>1,237,910</u>	\$ <u>1,399,804</u>

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

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

#### Description of Current and Expected Conditions

The management of KLC is not aware of any other significant changes in conditions that would have a significant effect on the financial position or results of operations of the Organization in the near future.

#### Contacting KLC's Financial Management

This financial report is designed to provide a general overview of KLC and its subsidiaries' finances and to show KLC's accountability to its members. If you have questions about this report or need additional information, contact KLC's office at 100 E. Vine St., Lexington, KY 40507.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Consolidated Statements of Net Position

June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,933,758	\$ 4,313,826
Investments	5,705,761	4,254,720
Accounts receivable	198,576	689,895
Premiums receivable	51,650	61,286
Prepaid expenses and other assets	498,702	395,249
Due from related parties	<u>1,091,557</u>	<u>760,187</u>
Total current assets	11,480,004	10,475,163
Capital assets, net	<u>7,999,913</u>	<u>8,431,777</u>
Total assets	19,479,917	18,906,940
<b>Deferred Outflows of Resources</b>		
Deferred amount on pension plan contributions	<u>814,449</u>	<u>-</u>
Combined assets and deferred outflows of resources	20,294,366	18,906,940
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	273,368	297,729
Accrued liabilities	961,503	832,621
Unearned revenue	622,784	1,043,149
Due to related parties	483,451	206,511
Current maturities of note payable	51,872	50,137
Current maturities of bond payable	<u>287,640</u>	<u>279,442</u>
Total current liabilities	2,680,618	2,709,589
Note payable, net of current maturities	813,982	865,855
Bond payable, net of current maturities	2,816,672	3,104,312
Net pension liability	<u>6,466,000</u>	<u>-</u>
Total liabilities	12,777,272	6,679,756
<b>Deferred Inflows of Resources</b>		
Deferred amount related to pension plan	<u>722,000</u>	<u>-</u>
Combined liabilities and deferred inflows of resources	<u>13,499,272</u>	<u>6,679,756</u>
<b>Net Position</b>		
Invested in fixed assets, net of related debt	4,029,747	4,132,031
Unrestricted	<u>2,765,347</u>	<u>8,095,153</u>
Total net position	\$ <u>6,795,094</u>	\$ <u>12,227,184</u>

See accompanying notes.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Consolidated Statements of Revenues, Expenses and Changes in Net Position

Years ended June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Operating revenue:		
Administrative fee - KLCIS	\$ 4,591,085	\$ 3,973,309
Administrative fee - KLCWCT	1,721,364	1,828,820
Administrative fee - Bond Pools	579,578	632,244
Administrative fee - KLCUCRT	119,434	104,342
Administrative fee - KSBIT	131,221	350,000
Commissions	2,688,813	2,711,789
Member dues	492,224	465,638
Member meeting and training income	358,100	327,119
Premium finance revenue	176,533	169,420
Other	309,416	256,175
Publication income	<u>23,822</u>	<u>5,560</u>
Total operating revenue	11,191,590	10,824,416
Operating expenses	<u>10,944,383</u>	<u>10,786,037</u>
Operating income	247,207	38,379
Nonoperating revenue (expenses):		
Interest and investment income	54,185	470,084
Interest expense	(101,101)	(106,115)
Gain on sale of fixed assets	48,505	-
Net rental income	<u>989,114</u>	<u>997,456</u>
Total nonoperating revenue	<u>990,703</u>	<u>1,361,425</u>
Change in net position before cumulative effect of a change in accounting principle	1,237,910	1,399,804
Cumulative effect on prior years (to June 30, 2014) resulting from the retroactive change in accounting for pensions (Note 2)	<u>(6,670,000)</u>	<u>-</u>
Change in net position	(5,432,090)	1,399,804
Net position, beginning of year	<u>12,227,184</u>	<u>10,827,380</u>
Net position, end of year	\$ <u>6,795,094</u>	\$ <u>12,227,184</u>

See accompanying notes.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

Years ended June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
<b>Cash flows from operating activities:</b>		
Cash received from members and affiliates	\$ 11,267,017	\$ 11,080,351
Cash paid to suppliers and employees	<u>(10,391,419)</u>	<u>(10,071,950)</u>
Net cash provided by operating activities	875,598	1,008,401
<b>Cash flows from noncapital financing activities:</b>		
Payments to related parties	<u>(54,430)</u>	<u>141,279</u>
Net cash (used in) provided by noncapital financing activities	(54,430)	141,279
<b>Cash flows from capital and related financing activities:</b>		
Capital expenditures	(411,318)	(1,722,195)
Proceeds from sale of fixed assets	48,505	-
Principal payments on bond payable	(279,442)	(271,370)
Proceeds from note payable	-	960,000
Principal payments on note payable	(50,138)	(44,008)
Interest paid	<u>(101,101)</u>	<u>(106,115)</u>
Net cash used in capital and related financing activities	(793,494)	(1,183,688)
<b>Cash flows from investing activities:</b>		
Proceeds from sale and maturity of investments	2,241,207	1,068,306
Interest and income on investments	133,517	405,799
Purchase of investments	(3,771,580)	(1,037,072)
Proceeds from rental activities	<u>989,114</u>	<u>997,456</u>
Net cash (used in) provided by investing activities	<u>(407,742)</u>	<u>1,434,489</u>
Net (decrease) increase in cash and cash equivalents	(380,068)	1,400,481
Cash and cash equivalents, beginning of year	<u>4,313,826</u>	<u>2,913,345</u>
Cash and cash equivalents, end of year	<u>\$ 3,933,758</u>	<u>\$ 4,313,826</u>

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows, continued

Years ended June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 247,207	\$ 38,379
Adjustments:		
Depreciation and amortization	848,978	784,377
Pension liability, net of deferred inflows and outflows of resources	(296,449)	-
Provision for bad debts	5,163	392
Increase (decrease) in cash due to changes in:		
Accounts receivable	486,156	(449,545)
Premiums receivable	9,636	20,415
Prepaid expenses and other assets	(109,249)	289,983
Accounts payable	(24,361)	67,082
Accrued liabilities	128,882	(225,316)
Unearned revenue	<u>(420,365)</u>	<u>482,634</u>
Net cash provided by operating activities	\$ <u>875,598</u>	\$ <u>1,008,401</u>

See accompanying notes.

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

#### 1. Nature of Organization and Operations

The Kentucky League of Cities, Inc. and Subsidiaries (KLC) is an incorporated association of cities whose purpose is to provide legislative, financial, insurance, and legal assistance to its members. This is primarily accomplished through lobbying, publications and training seminars. KLC publishes a monthly newsletter and a weekly bulletin on the status of legislation. KLC's revenues are substantially comprised of fees earned for administration of entities related to KLC and member dues. Member dues are based on the members' respective populations.

Kentucky League of Cities Insurance Agency (KLCIA) was incorporated on December 27, 1995 by its sole stockholder, KLC. KLCIA was organized to transact business as an insurance agency. KLCIA sells health, life, and bonding insurance to municipalities in the Commonwealth of Kentucky and also markets insurance offered by other KLC related entities.

Kentucky League of Cities Premium Finance Company (KLCRFC) was incorporated on March 26, 2003 by its sole stockholder, KLC. KLCRFC was organized to finance insurance premiums for member cities. See also Note 7.

The consolidated financial statements of KLC include the accounts of KLC, KLCIA, and KLCRFC. All significant intercompany balances and transactions have been eliminated upon consolidation.

The following entities are KLC related entities:

- Kentucky Bond Corporation (KBC)
- Kentucky Bond Development Corporation (KBDC)
- Kentucky League of Cities Funding Trust (KLCFT)
- Kentucky League of Cities Investment Pool (KLCIP)
- Kentucky League of Cities Insurance Services (KLCIS)
- Kentucky League of Cities Unemployment Compensation Reimbursement Trust (KLCUCRT)
- Kentucky League of Cities Workers Compensation Trust (KLCWCT)
- Kentucky Local Government Health Trust (KLGHT)
- Kentucky School Boards Insurance Trust Workers Compensation Fund (KSBITWCF)
- Kentucky School Boards Insurance Trust Property and Liability Fund (KSBITPLF)

#### 2. Summary of Significant Accounting Policies

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) which require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The following is a summary of the significant accounting policies consistently followed by KLC in the preparation of its consolidated financial statements.

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements, continued

#### 2. Summary of Significant Accounting Policies, continued

##### Basis of Presentation

KLC presents its financial statements in conformity with GAAP as applied to government units. Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. As a proprietary activity, KLC has adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. Therefore, KLC follows GASB pronouncements and all Financial Accounting Standards Board and predecessor boards' pronouncements except those that conflict with or contradict GASB pronouncements.

Operating revenues are those revenues that are generated from the primary operations. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations. All other expenses are reported as non-operating expenses.

##### Change in Accounting Principle

Effective July 1, 2014, KLC was required to adopt GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* (Statement 68). Statement 68 replaced the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and GASB Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Statement 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability to more comprehensively and comparably measure the annual costs of pension benefits. Cost-sharing governmental employers, such as KLC, are required to report a net pension liability, pension expense and pension-related assets and liabilities based on their proportionate share of the collective amounts for all governments in the plan.

KLC has elected to utilize the cumulative effect of a change in accounting principle option permitted by Statement 68 as KLC has determined that restatement of all prior periods presented is not practical. The adjustment resulted in a \$6,670,000 reduction in beginning net position for 2015.

##### Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

KLC has a concentration of credit risk in that it periodically maintains bank accounts which, at times, may exceed the coverage provided by the Federal Deposit Insurance Corporation (FDIC). Cash equivalents include investments in a money market fund that are not FDIC insured.

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements, continued

#### 2. Summary of Significant Accounting Policies, continued

##### Investments

Investment securities consist of U.S. government agency equity securities and mutual funds consisting of governmental securities and debt and equity securities. Investments are stated at fair value based, generally, on quoted market prices.

Realized gains and losses on investments are calculated as the difference between the proceeds of the sale and the original cost of the investments sold. This calculation is independent of the calculation of the net change in the fair value of investments. Realized gains and losses on investments that were held in prior years and sold in the current year were included as a net change in the fair value of investments as reported in the prior year.

##### Fixed Assets

Fixed assets consisting of land, buildings, parking lot and improvements, furniture, equipment, and building and land improvements, are stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets.

<u>Asset Type</u>	<u>Useful Life</u>
Buildings	39 years
Furniture and fixtures	2-15 years
Improvements	15-20 years

When properties are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the account with any resulting gain or loss reflected in income.

##### Income Taxes

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

##### Unearned Revenue

Unearned revenue consists of KLC members' dues and premiums financed through KLCPFC. Members' annual dues are billed in advance throughout the year. These dues are deferred and subsequently recognized on a pro-rata basis. Total unearned revenue related to members' dues was \$256,500 and \$232,816 as of June 30, 2015 and 2014, respectively. KLCPFC finances insurance premiums for members of KLCIS throughout the year. Those premium amounts that are received in advance of the policy period are classified as advanced (unearned) revenue until earned. Total unearned premiums as of June 30, 2015 and 2014 were \$128,581 and \$147,187, respectively. Unearned revenue also includes convention, administrative fees, advertising fees and rent received in advance. Total other unearned revenue for KLC as of June 30, 2015 and 2014 was \$198,847 and \$407,098, respectively.

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements, continued

#### 2. Summary of Significant Accounting Policies, continued

##### Unearned Revenue, continued

Additionally, KLCIA has received commissions from certain insurance carriers for advance premiums sold to member cities. These commissions are earned over the life of the premium policy period. Total unearned revenue for KLCIA as of June 30, 2015 and 2014 was \$38,856 and \$256,048, respectively.

##### Pensions

KLC participates in the County Employees Retirement System (CERS) administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost sharing, multiple employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members.

In accordance with Statement 68, cost-sharing governmental employers, such as KLC, are required to report a net pension liability, pension expense and pension-related assets and liabilities based on their proportionate share of the collective amounts for all governments in the plan. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of CERS and additions to or deductions from CERS' fiduciary net position have been determined on the same basis as they are reported by CERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

All governments participating in the defined benefit pension plan also are required to disclose various information in the footnotes to the consolidated financial statements – see Note 6.

##### Reclassifications

Certain amounts in the 2014 financial statements have been reclassified for comparative purposes to conform with the 2015 presentation. These reclassifications increased total assets and liabilities by \$396,693 and had no impact on net position or the change in net position.

##### Restatement

During fiscal 2015, KLC became aware that its fiscal 2014 commissions revenue from a related party was understated due to a check from KLCIS written on June 25, 2014 not being deposited until July 3, 2014 and not included in the outstanding deposits in the bank reconciliation. The cash was owed to KLCIA. However, at the time, KLCIA did not have a separate bank account so KLC held the funds on behalf of KLCIA. Based on an administrative agreement, 90% of KLCIA's transactions ultimately flow through to KLC. As such, KLC added \$687,418 to its previously reported cash balance and KLCIA added \$687,418 to its previously reported commissions revenue balance, effective June 30, 2014. The net impact of this restatement was an increase to 2014 change in net position by \$687,418.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements, continued

### 2. Summary of Significant Accounting Policies, continued

#### Subsequent Events

KLC's management evaluated the period from July 1, 2015 to September 22, 2015 (the date the consolidated financial statements were ready to be issued) for subsequent events. Except as disclosed in Note 11, there were no events occurring during the evaluation period that require recognition or disclosure in the consolidated financial statements.

### 3. Deposits and Investments

Deposits and investments held by KLC as of June 30 are as follows:

	<u>2015</u>	<u>2014</u>
Deposits and investments classified as cash and cash equivalents:		
Cash and cash equivalents	\$ 3,743,792	\$ 3,870,403
Money market mutual funds	<u>189,966</u>	<u>443,423</u>
Total deposits	3,933,758	4,313,826
Investments classified as investment securities:		
U.S. government agencies and municipal obligations	1,483,663	1,300,743
Corporate and foreign bonds	716,680	413,862
Bond mutual funds	398,302	-
Equity mutual funds	219,787	386,673
Equity securities	<u>2,887,329</u>	<u>2,153,442</u>
Total investments	<u>5,705,761</u>	<u>4,254,720</u>
Total deposits and investments	<u>\$ 9,639,519</u>	<u>\$ 8,568,546</u>

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

	<u>2015</u>	<u>2014</u>
Interest and dividend income	\$ 66,498	\$ 138,504
Realized gains on sales of securities	67,020	267,295
Unrealized (losses) gains on securities	<u>(79,333)</u>	<u>64,285</u>
	<u>\$ 54,185</u>	<u>\$ 470,084</u>

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements, continued

#### 3. Deposits and Investments, continued

##### Interest Rate Risk

Interest rate risk is the risk that interest rates will change and cause a decrease in the value of an entity's investments. KLC does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

##### Credit Risk

Credit risk is the risk that issuers of securities owned by an entity will default or that other parties that owe the entity money will not pay. KLC minimizes these risks by adhering to a conservative investment strategy, by utilizing sound financial advice of reputable investment advisors, by maintaining credit and collection policies, and by providing an allowance for any amounts deemed uncollectible.

As of June 30, 2015, KLC was invested in several U.S. government agency bonds, state and local municipal bonds, corporate and foreign bonds which have the following ratings as of June 30, 2015:

AAA	\$ 59,184
AA	271,833
A	335,014
Below A	50,649
Not rated or other	<u>1,483,663</u>
	<u>\$ 2,200,343</u>

##### Concentration of Credit Risk

KLC's investment policy limits investments in any single holding to no more than 5% of the market value of the account, except for bonds issued by the Kentucky Bond Corporation, up to an aggregate limit of \$2,000,000, as well as setting guidelines for the type and quality of investments. At June 30, 2015 and 2014, KLC had one investment that exceeded the 5% limit, which was within the policy guidelines as it was a series of bonds issued by the Kentucky Bond Corporation.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements, continued

### 3. Deposits and Investments, continued

As of June 30, 2015, KLC had the following investment maturities:

	Investment Maturities (in years)			
	Less than 1	1-5	6-10	More than 10
Corporate bonds	\$ -	\$ 355,146	\$ 361,534	\$ -
U.S. government agencies and municipal obligations	-	49,746	50,308	1,383,609
Total maturities	\$ -	\$ 404,892	\$ 411,842	\$ 1,383,609

### 4. Capital Assets

Capital asset activity for the year ended June 30, 2015 is as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Capital assets at cost:				
Land	\$ 674,175	\$ -	\$ -	\$ 674,175
Buildings	6,427,420	4,405	-	6,431,825
Parking lot and improvements	1,239,306	-	-	1,239,306
Furniture and fixtures	2,745,269	205,403	(157,798)	2,792,874
Improvements	5,289,173	201,510	-	5,490,683
Total capital assets at cost	16,375,343	411,318	(157,798)	16,628,863
Less: accumulated depreciation	(7,943,566)	(843,182)	157,798	(8,628,950)
Total net capital assets	\$ 8,431,777	\$ (431,864)	\$ -	\$ 7,999,913

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements, continued

### 4. Capital Assets, continued

Capital asset activity for the year ended June 30, 2014 is as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Capital assets at cost:				
Land	\$ 674,175	\$ -	\$ -	\$ 674,175
Buildings	6,427,420	-	-	6,427,420
Parking lot and improvements	-	1,239,306	-	1,239,306
Furniture and fixtures	2,644,162	101,107	-	2,745,269
Improvements	<u>4,907,391</u>	<u>381,782</u>	<u>-</u>	<u>5,289,173</u>
Total capital assets at cost	14,653,148	1,722,195	-	16,375,343
Less: accumulated depreciation	<u>(7,164,985)</u>	<u>(778,581)</u>	<u>-</u>	<u>(7,943,566)</u>
Total net capital assets	<u>\$ 7,488,163</u>	<u>\$ 943,614</u>	<u>\$ -</u>	<u>\$ 8,431,777</u>

### 5. Long Term Debt

#### Bond Payable

On March 1, 2006, KLC issued an adjustable rate, taxable 2006 series bond in the amount of \$5,000,000. On December 1, 2009, this bond was refinanced by three 15-year variable rate bonds. Repayment on these bonds began January 1, 2011. The interest rate on the bonds as of June 30, 2015 and 2014 was 0.08% and 0.07%, respectively. The bonds are included in the bond pools that are administered by KLC (see Note 8). The bonds bear interest at variable rates based on the SIFMA municipal index. In order to secure the loan, KLC pledged the following as security for the loan repayment: all rental income derived from the building, \$2,000,000 of KLC's investments, and a negative lien pledge/covenant on the building. The following is a schedule of the required future principal payments in accordance with the refinancing agreement.

Year ending June 30,

2016	\$ 287,640
2017	296,246
2018	305,002
2019	314,065
2020	323,300
Thereafter	<u>1,578,059</u>
	<u>\$ 3,104,312</u>

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements, continued

#### 5. Long Term Debt, continued

##### Note Payable

On July 10, 2013, KLC signed a promissory note with a financial institution in the amount of \$960,000, for the purpose of purchasing a parking lot. This note has a fixed interest rate of 3.79% for the term of the note, which is 15 years. The note is secured by the deed to the parking lot. The following is a schedule of the required future principal payments in accordance with the promissory note.

Year ending June 30,		
2016	\$	51,872
2017		53,990
2018		56,101
2019		58,295
2020		60,511
Thereafter		<u>585,085</u>
	\$	<u>865,854</u>

#### 6. Retirement Plans

##### 457 Deferred Compensation Plan

KLC previously offered its employees a deferred compensation plan created in accordance with Internal Revenue Code (IRC) Section 457 in which KLC contributed 10% of each participant's annual salary. Contributions by KLC to this plan ceased in April 1994, however, the plan remains as a strictly voluntary plan and all full-time employees are eligible to participate from the time of hire.

##### 401(a) Deferred Compensation Plan

In April 1994, KLC created a plan in accordance with IRC Section 401(a) that was available to all full-time employees who had completed one year of service. Only employees hired prior to September 1, 2000 may elect to participate in this plan. KLC made contributions to the 401(a) plan of 10% of each eligible participant's annual salary.

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements, continued

#### 6. Retirement Plans, continued

##### County Employees Retirement System (CERS) Deferred Compensation Plan

*Plan description* – Beginning September 1, 2000, KLC has elected to participate in CERS, pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost sharing, multiple employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Benefit contributions and provisions are established by statute. CERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601-6124 or by calling (502) 696-8800.

*Benefits provided* – CERS provides retirement, disability, and death benefits. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008 must meet the rule of 87 (members age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months service credit. All KLC employees are deemed nonhazardous.

Each employee covered by CERS is entitled to a monthly benefit based upon their months of service multiplied by the average of 5 full fiscal years of salary (highest 5 or last 5 based on date of participation) upon attainment of CERS specified age (or age and service combinations). Participants have a fully vested interest after the completion of 60 months of service, 12 of which are current service.

Retirement benefits are determined as 2.5 percent of the employee's final 3-year average compensation times the employee's years of service. Employees with 10 years of continuous service are eligible to retire at age 60. Employees are eligible for service-related disability benefits regardless of length of service. Five years of service is required for nonservice-related disability eligibility. Disability benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction. Death benefits equal the employee's final full-year salary.

*Contributions* – Benefit and contribution rates are established by state statute. Nonhazardous covered employees are required to contribute 5.00% of their salary to the plan. Nonhazardous covered employees who begin participation on or after September 1, 2008, are required to contribute 6.00% of their salary to the plan. KLC's contribution rate for nonhazardous employees was 17.67%, 18.89% and 19.55% for the years ended June 30, 2015, 2014 and 2013, respectively.

KLC's contributions to CERS for the years ended June 30, 2015, 2014, and 2013 amount to \$814,449, \$863,584, and \$971,693 respectively.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements, continued

### 6. Retirement Plans, continued

#### County Employees Retirement System (CERS) Deferred Compensation Plan, continued

*Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions* – At June 30, 2015, KLC reported a liability of \$6,466,000 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. KLC's proportion of the net pension liability was based on a projection of KLC's long-term share of contributions to the pension plan relative to the projected contributions of all participating organizations, actuarially determined. At June 30, 2015, KLC's proportion was 0.199%.

For the year ended June 30, 2015, KLC recognized pension expense of \$518,000. At June 30, 2015, KLC reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual earnings on pension plan investments	\$ -	\$ 722,000
District's contributions subsequent to the measurement date of June 30, 2014	<u>814,449</u>	<u>-</u>
Total	<u>\$ 814,449</u>	<u>\$ 722,000</u>

The deferred outflows of resources relate to KLC's contributions to the CERS plan subsequent to the measurement date and will be recognized as a reduction of the net pension liability in the year ending June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ending June 30:	
2016	\$ 180,500
2017	180,500
2018	180,500
2019	<u>180,500</u>
Total	<u>\$ 722,000</u>

*Actuarial assumptions* – The total pension liability in the June 30, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.5 percent
Salary increases	4.5 percent, average, including inflation
Investment rate of return	7.75 percent, net of pension plan investment expense, including inflation

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements, continued

### 6. Retirement Plans, continued

#### County Employees Retirement System (CERS) Deferred Compensation Plan, continued

The rates of mortality for the period after service retirement are according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006, and the 1994 Group Annuity Mortality Table for all other members. The Group Annuity Mortality Table set forward five years is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the period July 1, 2005 to June 30, 2008.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long Term Nominal Rate of Return
Domestic Equity	30%	8.45%
International Equity	22%	8.85%
Emerging Market Equity	5%	10.50%
Private Equity	7%	11.25%
Real Estate	5%	7.00%
Core US Fixed Income	10%	5.25%
Non US Fixed Income	5%	7.25%
Commodities	5%	5.5%
TIPS	5%	7.75%
Cash	5%	5.00%
	1%	3.25%
Total	100%	

*Discount rate* – The discount rate used to measure the total pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members and employers will be made at statutory contribution rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payment of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements, continued

### 6. Retirement Plans, continued

#### County Employees Retirement System (CERS) Deferred Compensation Plan, continued

*Sensitivity of the KLC's proportionate share of the net pension liability to changes in the discount rate* – The following presents KLC's proportionate share of the net pension liability calculated using the discount rate of 7.75%, as well as what the KLC's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.75%) or 1 percentage point higher (8.75%) than the current rate:

	1% Decrease (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
KLC's share of the net pension liability	\$ 8,508,576	\$ 6,466,000	\$ 4,660,982

*Pension plan fiduciary net position* – Detailed information about the pension plan's fiduciary net position is available in the separately issued CERS financial report.

### 7. Premium Financing Activities

As mentioned in Note 1 to the consolidated financial statements, KLCPFPC was organized to finance insurance premiums for member cities that purchase property, liability and workers compensation insurance from KLCIS and KLCWCT (the Insurance Companies), respectively. KLCPFPC enters into short-term financing agreements with member cities who wish to finance their premiums over a period of time. The length of the financing contracts range from six to twelve months and the finance charges range from 4.25% to 7.99% depending on the dollar amount of the premium financed. KLCPFPC also requires a 20% down payment on all amounts financed.

When a member signs a financing contract, KLCPFPC recognizes a receivable from the member city and a payable to the Insurance Companies. Premium amounts financed are transferred on a monthly basis to the Insurance Companies. Should a member be cancelled or withdraw from the insurance plans, KLCPFPC would receive the unearned amount of the premium from the Insurance Companies. KLCPFPC recognizes premium finance revenue as earned based upon the terms of the contract. Total premium finance income for June 30, 2015 and 2014 was \$176,533 and \$169,420, respectively. Total premiums receivable as of June 30, 2015 and 2014 were \$51,650 and \$61,286, respectively. Total premiums due to the Insurance Companies as of June 30, 2015 and 2014 were \$521,266 and \$595,809, respectively, and are included within the due to/from related parties on the consolidated balance sheets.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements, continued

### 8. Administration Fees

Revenues for the years ended June 30, 2015 and 2014 include administrative fees and commissions from the following related parties, together with receivables and payables due to and from these affiliates:

	Fees and Commissions		Receivables and (Payables)	
	2015	2014	2015	2014
KLCIS	\$ 5,556,135	\$ 4,864,198	\$ 673,384	\$ 442,089
KLCWCT	2,018,433	2,248,284	(65,278)	132,637
KLCUCRT	119,434	104,342	-	(20,890)
KSBITPLF	49,840	199,360	-	-
KSBITWCF	50,213	150,640	-	-
KBC	321,711	316,404	-	-
KBDC	25,765	-	-	-
KLCFT	232,102	308,873	-	-
KLIGHT	-	-	-	(160)

KLC has an administrative agreement with KLCIS, KLCWCT, and KLCUCRT to provide substantially all operational, management and administrative services in exchange for a reimbursement of administrative costs. Additionally, KLCIA entered into a marketing agreement with KLCIS and KLCWCT which provides that KLCIS and KLCWCT pay a commission to KLCIA for insurance which KLCIA markets and an administrative fee, as a percentage of premiums, for general marketing. Each agreement is subject to termination by either party upon 90 days written notice.

KLC has an administrative agreements with KSBITPLF and KSBITWCT (collectively, KSBIT) to provide substantially all operational, management and administrative services in exchange for a reimbursement of administrative costs and a management fee, calculated as a percentage of annual gross premiums. During the year ended June 30, 2013, the agreement was modified at the direction of the Kentucky Department of Insurance to discontinue the management fee due to KLC because of KSBIT's net position. KLC assisted KSBIT during its transition to another administrator and these agreements were terminated on November 1, 2014 and November 30, 2014, for KSBITPLF and KSBITWCT, respectively.

KLC has an administrative agreement with KBC to provide monitoring of bond proceeds, origination of financing agreements, servicing of financing agreements, and other administrative services, in exchange for an administrative fee. This fee is comprised of an initial issuance fee and a financing fee equal to .25% of the aggregate unpaid principal components of all financing payments calculated on a quarterly basis, payable to the extent that monies are available in KBC's reserve funds. For the years ended June 30, 2015 and 2014, KBC issued approximately \$21.6 million and \$28 million, respectively, in bonds. The agreement is subject to termination by either party with 30 days written notice. The President and Second Vice President of KLC serve as members, non-voting and voting, respectively, of the Board of Trustees of KBC and the KLC Executive Board appoints the remaining 4 members of KBC's Board of Trustees.

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements, continued

#### 8. Administration Fees, continued

KLC provides similar services for commensurate fees to KBDC as is provided to KBC.

KLC functions as the program administrator for KLCFT, which provides tax-exempt financing to members of KLC. In exchange for administrative services performed KLCFT pay's KLC an administrative fee. Additionally, KLC finances three lease agreements through the KLCFT, with outstanding principal balances of \$3,104,312 and \$3,383,754, as of June 30, 2015 and 2014, respectively.

KLC also functions as the program administrator for KLCIP, which provides pooled investment services to members of KLC. The KLC Executive Board appoints the members of KLCIP's Board of Trustees. KLC did not receive an administrative fee for 2015 or 2014.

#### 9. Litigation

On August 26, 2014, the Department filed a suit against KLC, KLCIS, and the Kentucky School Boards Association for an unspecified amount of damages related to the administration of KSBIT. Specifically, the complaint contains allegations of negligence and misrepresentation in connection with the management of KSBITWCF and KSBITPLF. The allegations against KLC and KLCIS are limited to the time period beginning January 2010 through July 2013. KLC and KLCIS strongly deny the allegations. Discovery is ongoing and defense counsel contends that both entities have a strong defense and the potential for liability is low. KLC and KLCIS are covered by an Errors and Omissions and Directors' and Officers' Liability Policy issued by Lloyds of London through Broker's Risk Services with a \$10 million limit. The claim has been reported to the carrier and a defense is being provided for both entities under the policy.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements, continued

### 10. Operating Expenses

Operating expenses for 2015 and 2014 by natural classification are as follows:

	<u>2015</u>	<u>2014</u>
Salaries	\$ 5,836,097	\$ 5,762,322
Employee benefits	858,146	667,619
Depreciation and amortization	848,978	784,377
Retirement	641,066	981,951
Professional services	548,653	435,100
Other expenses	437,341	489,596
Payroll taxes	409,072	393,998
Meetings	361,698	289,568
Building management	304,498	337,867
Travel	137,486	131,760
Legislative services	125,699	135,659
Program and development	100,986	53,040
Telephones	92,562	96,931
Dues	59,993	58,035
Publications	51,208	28,526
Postage	50,493	41,857
Office supplies	47,010	45,001
KLCPFC finance expenses	28,634	47,456
Bond administration	<u>4,763</u>	<u>5,374</u>
	<u>\$ 10,944,383</u>	<u>\$ 10,786,037</u>

Operating expenses for 2015 and 2014 by functional classification are as follows:

	<u>2015</u>	<u>2014</u>
Administrative and general	\$ 3,602,182	\$ 4,110,406
Member insurance services	5,369,742	4,926,802
Legislative services	1,463,728	1,378,477
Member financial services	262,321	189,476
Member meeting and training services	<u>246,410</u>	<u>180,876</u>
	<u>\$ 10,944,383</u>	<u>\$ 10,786,037</u>

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements, continued

#### 11. Subsequent Event

On September 16, 2015, KLCPFC entered into a \$6,000,000 line of credit agreement with a financial institution with a variable interest rate based on the 30-day LIBOR rate plus 1.9%. This line of credit matures on April 30, 2016. KLC is a guarantor on the line of credit. The complete line of credit was drawn on September 16, 2015, in order for KLCPFC to pay KLCIS in full for premiums financed by members.

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

Board of Directors  
Kentucky League of Cities, Inc. and Subsidiaries  
Lexington, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Kentucky League of Cities, Inc. and Subsidiaries (KLC) as of and for the year ended June 30, 2015, and the related notes to the consolidated financial statements, which collectively comprise KLC's basic consolidated financial statements, and have issued our report thereon dated September 22, 2015.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the consolidated financial statements, we considered KLC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of KLC's internal control. Accordingly, we do not express an opinion on the effectiveness of KLC's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We consider the deficiency described in the accompanying Schedule of Findings and Responses to be a significant deficiency.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether KLC's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of consolidated 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*.

### Management's Response to Finding

Management's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Responses. Management's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Dean Dorton Allen Ford, PLLC*

September 22, 2015  
Lexington, Kentucky

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Schedule of Findings and Responses

Year ended June 30, 2015

#### Section I - Summary of Auditors' Results

- a. The type of report issued on the financial statements: **Unmodified opinion**
- b. Material weaknesses identified in the internal control over financial reporting: **No**
- c. Significant deficiencies identified in the internal control over financial reporting: **Yes**
- d. Non-compliance which is material to the financial statements: **No**

#### Section II - Summary of Findings and Responses

##### Finding 2015-001:

###### *Criteria, Condition, and Effect:*

During the 2015 audit of a related entity, it came to our attention that the 2014 KLCIA commission revenue was understated by \$687,418. This understatement occurred because an intercompany commission check from KLCIS, written on June 25, 2014, was not deposited until July 3, 2014 and it was not included on the June 2014 bank reconciliation as a deposit in transit. KLC identified the error when the check was deposited, but did not have a process in place to ensure that intercompany payments and receipts were recorded in the proper time period in both entities' accounting records. As a result, a material adjusting entry was required to restate the 2014 financial statements.

###### *Recommendation:*

We recommend that the additional step of scanning through the subsequent month's deposits and checks for potential intercompany outstanding items be included in the monthly bank reconciliation process. In addition, the review of bank reconciliations should be performed simultaneously in order to identify intercompany in transit deposits and checks at the reviewer level.

###### *Management Response:*

Management refined the process in place to review all intercompany in transit deposits and checks. In addition to the monthly bank reconciliation, a daily review of all deposits is performed to ensure that all checks received in the mailroom are logged daily and deposited timely to ensure the proper recording of all related entities transactions.

KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

Schedule of Findings and Responses, continued

Year ended June 30, 2015

**Finding 2015-002:**

*Criteria, Condition, and Effect:*

Understanding and monitoring executed agreements is important in providing for the services necessary for the performance of administrative services on behalf of related entities. During our audit, DDAF noted that there is not any executed contract with the Kentucky Bond Development Corporation.

*Recommendation:*

We recommend that, upon approval of services, executed agreements are prepared and approved by all parties to the contract.

*Management Response:*

Management will present the administrative agreement between KLC and the Kentucky Bond Development Corporation to the respective boards for approval on September 29, 2015.

## KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

### Schedule of Prior Year Findings

Year ended June 30, 2015

#### Section I - Status of Prior Year Findings

##### Finding 2014-001

###### *Criteria, Condition, and Effect:*

During the audit, we noted that administrative fees paid to a related entity have not been "trued up" from budgeted costs to actual costs incurred, in accordance with the administration agreement in place. This practice may lead to liabilities or assets of KLC not being recorded, which over time can cause misstatements to the financial statements.

###### *Recommendation:*

We recommend that the "true up" reconciliation between actual and budgeted administrative fees be performed. Additionally, we recommend that management perform a review of significant contracts and agreements for accounting implications and maintain a document that summarizes the accounting implications and the plan to ensure the proper accounting treatment.

###### *Current Year Status:*

This finding was resolved in the current year.

KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

Consolidating Statements of Net Position

June 30, 2015

	KLC	KLCIA	KLCPFC	Consolidating Entries	Consolidated Total
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$ 3,241,607	\$ 219,086	\$ 473,065	\$ -	\$ 3,933,758
Investments	4,670,995	1,334,766	-	(300,000)	5,705,761
Accounts receivable	188,639	9,937	-	-	198,576
Premiums receivable	-	-	51,650	-	51,650
Prepaid expenses and other assets	475,721	21,561	1,420	-	498,702
Due from related parties	<u>2,856,421</u>	<u>1,881,057</u>	<u>382,793</u>	<u>(4,028,714)</u>	<u>1,091,557</u>
Total current assets	11,433,383	3,466,407	908,928	(4,328,714)	11,480,004
Capital assets, net	<u>7,999,913</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,999,913</u>
Total assets	19,433,296	3,466,407	908,928	(4,328,714)	19,479,917
<b>Deferred Outflows of Resources</b>					
Deferred amount on pension plan contributions	<u>814,449</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>814,449</u>
Combined assets and deferred outflows of resources	20,247,745	3,466,407	908,928	(4,328,714)	20,294,366

KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

Consolidating Statements of Net Position, continued

June 30, 2015

	KLC	KLCIA	KLCPFC	Consolidating Entries	Consolidated Total
<b>Liabilities</b>					
Current liabilities:					
Accounts payable	265,470	7,898	-	-	273,368
Accrued liabilities	961,503	-	-	-	961,503
Unearned revenue	455,347	38,856	128,581	-	622,784
Due to related parties	1,655,744	2,856,421	-	(4,028,714)	483,451
Current maturities of note payable	51,872	-	-	-	51,872
Current maturities of bond payable	<u>287,640</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>287,640</u>
Total current liabilities	3,677,576	2,903,175	128,581	(4,028,714)	2,680,618
Note payable, net of current maturities	813,982	-	-	-	813,982
Bond payable, net of current maturities	2,816,672	-	-	-	2,816,672
Net pension liability	<u>6,466,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,466,000</u>
Total liabilities	13,774,230	2,903,175	128,581	(4,028,714)	12,777,272
<b>Deferred Inflows of Resources</b>					
Deferred amount related to pension plan	<u>722,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>722,000</u>
Combined liabilities and deferred inflows of resources	<u>14,496,230</u>	<u>2,903,175</u>	<u>128,581</u>	<u>(4,028,714)</u>	<u>13,499,272</u>
<b>Net Position</b>					
Invested in fixed assets, net of related debt	4,029,747	-	-	-	4,029,747
Unrestricted	<u>1,721,768</u>	<u>563,232</u>	<u>780,347</u>	<u>(300,000)</u>	<u>2,765,347</u>
Total net position	<u>\$ 5,751,515</u>	<u>\$ 563,232</u>	<u>\$ 780,347</u>	<u>\$ (300,000)</u>	<u>\$ 6,795,094</u>

See accompanying notes and report of independent auditors.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Consolidating Statements of Net Position

June 30, 2014

	<u>KLC</u>	<u>KLCIA</u>	<u>KLCPFC</u>	<u>Consolidating Entries</u>	<u>Consolidated Total</u>
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$ 3,562,190	\$ -	\$ 751,636	\$ -	\$ 4,313,826
Investments	4,554,720	-	-	(300,000)	4,254,720
Accounts receivable	447,917	241,978	-	-	689,895
Premiums receivable	-	-	61,286	-	61,286
Prepaid expenses and other assets	376,480	13,307	5,462	-	395,249
Due from related parties	<u>2,966,012</u>	<u>2,848,168</u>	<u>4,030</u>	<u>(5,058,023)</u>	<u>760,187</u>
Total current assets	11,907,319	3,103,453	822,414	(5,358,023)	10,475,163
Capital assets, net	<u>8,431,777</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,431,777</u>
Total assets	20,339,096	3,103,453	822,414	(5,358,023)	18,906,940

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Consolidating Statements of Net Position, continued

June 30, 2014

	KLC	KLCIA	KLCPFC	Consolidating Entries	Consolidated Total
<b>Liabilities</b>					
Current liabilities:					
Accounts payable	273,912	18,775	5,042	-	297,729
Accrued liabilities	832,153	468	-	-	832,621
Unearned revenue	639,914	256,048	147,187	-	1,043,149
Due to related parties	2,881,616	2,381,997	921	(5,058,023)	206,511
Current maturities of note payable	50,137	-	-	-	50,137
Current maturities of bond payable	<u>279,442</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>279,442</u>
Total current liabilities	4,957,174	2,657,288	153,150	(5,058,023)	2,709,589
Note payable, net of current maturities	865,855	-	-	-	865,855
Bond payable, net of current maturities	<u>3,104,312</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,104,312</u>
Total liabilities	<u>8,927,341</u>	<u>2,657,288</u>	<u>153,150</u>	<u>(5,058,023)</u>	<u>6,679,756</u>
<b>Net Position</b>					
Invested in fixed assets, net of related debt	4,132,031	-	-	-	4,132,031
Unrestricted	<u>7,279,724</u>	<u>446,165</u>	<u>669,264</u>	<u>(300,000)</u>	<u>8,095,153</u>
Total net position	<u>\$ 11,411,755</u>	<u>\$ 446,165</u>	<u>\$ 669,264</u>	<u>\$ (300,000)</u>	<u>\$ 12,227,184</u>

See accompanying notes and report of independent auditors.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Consolidating Statements of Revenues, Expenses and Changes in Net Position

Year ended June 30, 2015

	KLC	KLCIA	KLCPFC	Consolidating Entries	Consolidated Total
Operating revenue:					
Administrative fee - KLCIS	\$ 4,591,085	\$ -	\$ -	\$ -	\$ 4,591,085
Administrative fee - KLCWCT	1,721,364	-	-	-	1,721,364
Administrative fee - Bond Pools	579,578	-	-	-	579,578
Administrative fee - KLCUCRT	119,434	-	-	-	119,434
Administrative fee - Financial Services	75,000	-	-	(75,000)	-
Administrative fee - KSBIT	131,221	-	-	-	131,221
Commissions	2,419,932	2,688,813	-	(2,419,932)	2,688,813
Member dues	492,224	-	-	-	492,224
Member meeting and training income	358,100	-	-	-	358,100
Premium finance income	-	-	176,533	-	176,533
Other	275,387	25,084	8,945	-	309,416
Publication income	<u>23,822</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>23,822</u>
Total operating revenue	10,787,147	2,713,897	185,478	(2,494,932)	11,191,590
Operating expenses	<u>10,775,458</u>	<u>2,589,346</u>	<u>74,511</u>	<u>(2,494,932)</u>	<u>10,944,383</u>
Operating income	11,689	124,551	110,967	-	247,207
Nonoperating revenue (expenses):					
Interest and investment income (loss)	61,553	(7,484)	116	-	54,185
Interest expense	(101,101)	-	-	-	(101,101)
Gain on sale of fixed assets	48,505	-	-	-	48,505
Net rental income	<u>989,114</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>989,114</u>
Total nonoperating revenue (expenses)	<u>998,071</u>	<u>(7,484)</u>	<u>116</u>	<u>-</u>	<u>990,703</u>
Change in net position before cumulative effect of a change in accounting principle	1,009,760	117,067	111,083	-	1,237,910
Cumulative effect on prior years (to June 30, 2014) resulting from the retroactive change in accounting for pensions (Note 2)	<u>(6,670,000)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(6,670,000)</u>
Change in net position	(5,660,240)	117,067	111,083	-	(5,432,090)
Net position, beginning of year	<u>11,411,755</u>	<u>446,165</u>	<u>669,264</u>	<u>(300,000)</u>	<u>12,227,184</u>
Net position, end of year	<u>\$ 5,751,515</u>	<u>\$ 563,232</u>	<u>\$ 780,347</u>	<u>\$ (300,000)</u>	<u>\$ 6,795,094</u>

See accompanying notes and report of independent auditors.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Consolidating Statements of Revenues, Expenses and Changes in Net Position, continued

Year ended June 30, 2014

	KLC	KLCIA	KLCPFC	Consolidating Entries	Consolidated Total
Operating revenue:					
Administrative fee - KLCIS	\$ 3,973,309	\$ -	\$ -	\$ -	\$ 3,973,309
Administrative fee - KLCWCT	1,828,820	-	-	-	1,828,820
Administrative fee - Bond Pools	632,244	-	-	-	632,244
Administrative fee - KLCUCRT	104,342	-	-	-	104,342
Administrative fee - Financial Services	75,000	-	-	(75,000)	-
Administrative fee - KSBIT	350,000	-	-	-	350,000
Commissions	2,440,610	2,711,789	-	(2,440,610)	2,711,789
Member dues	465,638	-	-	-	465,638
Member meeting and training income	327,119	-	-	-	327,119
Premium finance revenue	-	-	169,420	-	169,420
Other	210,440	30,677	15,058	-	256,175
Publication income	<u>5,560</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,560</u>
Total operating revenue	10,413,082	2,742,466	184,478	(2,515,610)	10,824,416
Operating expenses	<u>10,551,453</u>	<u>2,619,529</u>	<u>130,665</u>	<u>(2,515,610)</u>	<u>10,786,037</u>
Operating (loss) income	(138,371)	122,937	53,813	-	38,379
Nonoperating revenue (expenses):					
Interest and investment income	469,641	327	116	-	470,084
Interest expense	(106,115)	-	-	-	(106,115)
Net rental income	<u>997,456</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>997,456</u>
Total nonoperating revenue	<u>1,360,982</u>	<u>327</u>	<u>116</u>	<u>-</u>	<u>1,361,425</u>
Change in net position	1,222,611	123,264	53,929	-	1,399,804
Net position, beginning of year	<u>10,189,144</u>	<u>322,901</u>	<u>615,335</u>	<u>(300,000)</u>	<u>10,827,380</u>
Net position, end of year	<u>\$ 11,411,755</u>	<u>\$ 446,165</u>	<u>\$ 669,264</u>	<u>\$ (300,000)</u>	<u>\$ 12,227,184</u>

See accompanying notes and report of independent auditors.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Schedules of Required Supplementary Information

### Schedule of the Proportionate Share of the Net Pension Liability

#### County Employees Retirement System (CERS) Deferred Compensation Plan (Amounts in thousands)

	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Portion of the net pension liability (asset)	0.20 %									
Proportionate share of the net pension liability (asset)	\$ 6,466									
Covered- Employee Payroll	\$ 4,591									
Proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll	140.84 %									
Plan fiduciary net position as a percentage of the total pension liability	66.80 %									

See accompanying notes and report of independent auditors.

# KENTUCKY LEAGUE OF CITIES, INC. AND SUBSIDIARIES

## Schedules of Required Supplementary Information

### Schedule of Contributions

#### County Employees Retirement System (CERS) Deferred Compensation Plan (Amounts in thousands)

	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Contractually required contribution	\$ 864									
Contributions in relation to the contractually required contribution	<u>864</u>									
Contribution deficiency (excess)	\$ <u>-</u>									
Covered-Employee Payroll	\$ 4,591									
Contributions as a percentage of covered-employee payroll	18.82 %									

*See accompanying notes and report of independent auditors.*