Financial Statements and Supplementary Information

for

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Years Ended June 30, 2019 and 2018
with Report of Independent Auditors

CONTENTS

DEANDORTON

Report of Independent Auditors

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

Report on the Financial Statements

We have audited the accompanying financial statements of Kentucky League of Cities Workers' Compensation Trust (the Trust) which comprise the statements of net position as of June 30, 2019 and 2018, the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of Kentucky League of Cities Workers' Compensation Trust as of June 30, 2019 and 2018, the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 - 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

The supplementary information on page 25 is presented for purposes of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Insurance of the Commonwealth of Kentucky. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The supplementary information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion on the supplementary information referred to above nor do we provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2019 on our consideration of the Trust's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is solely 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 effectiveness of the Trust's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Trust's internal control over financial reporting and compliance.

Dean Dorton Allen Ford, PLLC

Lexington, Kentucky
October 18, 2019

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Management's Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky League of Cities Workers' Compensation Trust (the Trust) provides an overview of the Trust's financial activity for the fiscal year ended June 30, 2019. It should be read in conjunction with the financial statements, which begin on page 6.

Using this Annual Report

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

Statements of Net Position

Table 1 shows all the assets and liabilities of the Trust and is presented on the accrual basis. The Trust's financial statements for 2018 were restated due to a change in the NLC Mutual Insurance Company bylaws which added surplus for prior periods (see Footnote 2). Total net position increased $2,206,066 for the current fiscal year, resulting in an overall increase in net position of $10,101,542 since 2015. This growth in surplus better positions the Trust in the event of possible adverse claims development while at the same time providing more rate stability for our members.

Table 1
Net Position

	2019	2018
Cash and investments	**$ 56,240,616**	$ 51,995,315
Capital and other assets	**2,015,194**	2,141,238
Total assets	**58,255,810**	54,136,553
Unpaid losses and loss adjustment expenses	**40,146,234**	38,749,870
Other liabilities	**3,062,822**	2,545,995
Total liabilities	**43,209,056**	41,295,865
Total net position	**$ 15,046,754**	$ 12,840,688

Statement of Revenues, Expenses and Changes in Net Position

Table 2 shows the revenues and expenses of the Trust and is also presented on the accrual basis. Net earned premium revenue increased $542,798, or 4.4%, from the prior fiscal year. Due to changes in current year unrealized gains and losses, investment related revenues increased $791,027. Although losses and loss adjustment expenses increased $1,076,899 due primarily to an increase in claim severity in the current year, prior year results developed at lower than expected amounts and claims settled at favorable values (see Footnote 7 for details). The Trust continues to focus on reducing medical costs and reported claims as discussed in the following paragraph. The overall net position of the Trust increased $2,206,066 for the current year.

Table 2
Change in Net Position

Year ended June 30,	**2019**	2018
Net premiums earned	**$ 12,885,302**	$ 12,342,504
Investment and other revenue and gains	**2,679,243**	1,850,796
Net gain on KSBIT settlement	**-**	2,455,000
Total revenue	**15,564,545**	16,648,300
Losses and loss adjustment expenses	**9,570,999**	8,494,100
General administrative expenses	**3,787,480**	3,678,879
Total expenses and losses	**13,358,479**	12,172,979
Change in net position	**$ 2,206,066**	$ 4,475,321

Description of Current and Expected Conditions

As of December 15, 2013, the Trust started using internal staff to adjust workers' compensation claims. The Trust still utilizes the services of a third-party administrator to adjust post award claims. There has been a significant reduction in the number of newly reported litigated claims since bringing claims handling inhouse. Loss Control visits continue to focus on members with higher frequency of losses and include quarterly follow up visits to assist members in reducing claims. All prior year claims are now reserved at a projected level sufficient to cover all expected future benefit obligations. This change from projecting ten years of future medical costs to lifetime estimates has been implemented over the past several years. All claims have been reviewed and revised based upon current information.

A third party telephonic nurse case manager has been engaged to compliment the current use of field case managers and to further assist in controlling escalating medical costs. Also, a managed care organization was implemented effective July 1, 2016. Under this system, the Company Nurse has become mandatory for all members to report claims. A nurse triages the injury on the front end to help direct the employee to the most appropriate level of care. The Trust also contracted with a third party to provide in-office nurse case management for routine injuries and field nurse case management for serious injuries. In addition, an approved Preferred Provider Network of physicians was developed for the treatment of work related injuries. The Trust's efforts continue to focus on reducing reported claims, efficiently closing claims and managing medical costs. These changes have been crucial to the improved results for recent years. Management anticipates that these changes will continue to strengthen and improve the long-term results of the Trust's program.

Contacting the Organization's Financial Management

This financial report is designed to provide a general overview of 2019 operations and to show the Trust's accountability to its members. If you have any questions about this report or need additional information, contact the Kentucky League of Cities office at 100 East Vine Street, Suite 800, Lexington, KY 40507.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Net Position

June 30, 2019 and 2018

		2019		2018
Assets				
Investment securities, at fair value	**$**	**35,424,745**	$	33,588,149
Cash and cash equivalents		**20,815,871**		18,407,166
Accounts receivable, net of allowance for doubtful accounts of $1,000 and 5,000 for 2019 and 2018, respectively		**52,616**		38,665
Excess insurance recoverable		**805,495**		989,736
Accrued investment income		**232,261**		223,799
Prepaid expenses		**7,634**		7,323
Membership in NLC Mutual Insurance Company		**917,188**		879,712
Equipment, net of accumulated depreciation of $211,197 and $209,194 for 2019 and 2018, respectively		**-**		2,003
Total assets		**58,255,810**		54,136,553
Liabilities				
Unpaid losses and loss adjustment expenses:				
Reported claims		**34,558,692**		32,743,210
Incurred but not reported claims		**4,494,846**		4,874,164
Unallocated loss adjustment expenses		**1,092,696**		1,132,496
Total unpaid losses and loss adjustment expenses		**40,146,234**		38,749,870
Accounts payable		**506,775**		332,004
Payable to related entities, net		**1,287,967**		421,062
Advance premiums		**1,268,080**		1,792,929
Total liabilities		**43,209,056**		41,295,865
Net Position				
Net position	**$**	**15,046,754**	$	12,840,688

See accompanying notes.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Revenues, Expenses and Changes in Net Position

Years ended June 30, 2019 and 2018

	2019	2018
Operating revenue:		
Net premiums earned	**$ 12,885,302**	$ 12,342,504
Operating expenses:		
Losses and loss adjustment expenses	**9,570,999**	8,494,100
Commission expense	**1,187,430**	1,139,023
Claims administration expense	**213,335**	181,136
Loss prevention expenses	**145,127**	123,961
Professional fees	**213,601**	236,079
Administrative fees, related entity	**1,834,014**	1,777,823
Other expenses	**193,973**	220,857
Total operating expenses	**13,358,479**	12,172,979
Operating (loss) income	**(473,177)**	169,525
Nonoperating revenue:		
Interest and investment revenue	**2,571,388**	1,780,361
Other income	**107,855**	70,435
Net gain on KSBIT settlement (Note 8)	**-**	2,455,000
Total nonoperating revenue	**2,679,243**	4,305,796
Change in net position	**2,206,066**	4,475,321
Net position, beginning of year	**12,840,688**	7,768,797
Restatement (Note 2)	**-**	596,570
Net position, end of year	**$ 15,046,754**	$ 12,840,688

See accompanying notes.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Cash Flows

Years ended June 30, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
Premiums collected	**$ 12,350,502**	$ 12,784,540
Losses and loss adjustment expenses paid	**(8,174,635)**	(8,211,209)
Underwriting and administrative expenses paid	**(2,328,760)**	(3,395,812)
Other (payments) receipts	**(164,732)**	454,209
Net cash provided by operating activities	**1,682,375**	1,631,728
Cash flows from investing activities:		
Purchases of investments	**(5,257,262)**	(8,965,076)
Proceeds from maturity of investments	**-**	971,653
Proceeds from sale of investments	**4,920,225**	6,042,649
Interest, dividends and gains received	**1,063,367**	1,093,739
Net cash provided by (used in) investing activities	**726,330**	(857,035)
Cash flows from capital and related financing activities:		
KSBIT settlement payments received	**-**	2,455,000
Net cash provided by financing activities	**-**	2,455,000
Net increase in cash and cash equivalents	**2,408,705**	3,229,693
Cash and cash equivalents, beginning of year	**18,407,166**	15,177,473
Cash and cash equivalents, end of year	**$ 20,815,871**	$ 18,407,166

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Cash Flows, continued

Years ended June 30, 2019 and 2018

	2019	2018
Reconciliation of operating (loss) revenue to net cash provided by operating activities:		
Operating (loss) revenue	**$ (473,177)**	$ 169,525
Adjustments:		
Depreciation	**2,003**	3,072
Recovery of doubtful accounts	**(4,000)**	-
Other income	**107,855**	70,435
Increase (decrease) in cash due to changes in:		
Accounts receivable	**(9,951)**	6,300
Excess insurance recoverable	**184,241**	(115,155)
Prepaid expenses	**(311)**	887,600
Membership in NLC Mutual Insurance Company	**(37,476)**	(41,887)
Unpaid losses and loss adjustment expenses	**1,396,364**	282,891
Accounts payable	**174,771**	(8,075)
Payable to related entities, net	**866,905**	(58,714)
Advance premiums	**(524,849)**	435,736
Net cash provided by operating activities	**$ 1,682,375**	$ 1,631,728

See accompanying notes.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements

1. Description of Organization

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

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

The Trust has received a Certificate of Filing from the Department of Insurance of the Commonwealth of Kentucky (the Department) but is exempt from most statutory requirements that commercial insurers must follow. The Trust's general objectives are to formulate, develop and administer, on behalf of the member political subdivisions, a workers' compensation insurance program and to obtain lower costs for that coverage. All coverages are written on an occurrence basis. Participation in the Trust included 370 and 365 members as of June 30, 2019 and 2018, respectively.

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

Following is a description of the most significant risks facing property/casualty insurers and how the Trust mitigates those risks:

<u>Legal/Regulatory Risk</u>

Legal/regulatory risk is the risk that changes in the legal or regulatory environment in which an insurer operates will occur and create additional losses or expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits or new legal theories may create cost for the insurer beyond those currently recorded in the financial statements. The Trust is exposed to this risk by writing all of its business in Kentucky, thus increasing its exposure to a single jurisdiction. This risk is reduced by underwriting and loss adjusting practices that identify and minimize the adverse impact of this risk.

<u>Credit Risk</u>

Credit risk is the risk that issuers of securities owned by an insurer will default or that other parties, including excess insurance carriers that owe the insurer money will not pay. The Trust minimizes this risk by adhering to a conservative investment strategy, by utilizing financially sound excess insurance carriers, by maintaining credit and collection policies, and by providing an allowance for any amounts deemed uncollectible.

1. Description of Organization, continued

<u>Interest Rate Risk</u>

Interest rate risk is the risk that interest rates will change and cause a decrease in the value of an insurer's investments. The Trust mitigates this risk by attempting to match the maturity schedule of its assets with the expected payouts of its liabilities. To the extent that liabilities come due more quickly than assets mature, the Trust would have to sell assets prior to maturity and recognize a gain or loss. The Trust uses the segmented time distribution method to measure interest rate risk.

2. Summary of Significant Accounting Policies

<u>Basis of Accounting</u>

The Trust uses the accrual basis of accounting. Under this method, revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred.

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

<u>Use of Estimates</u>

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of unpaid losses and loss adjustment expenses. In connection with the determination of unpaid losses and loss adjustment expenses, management uses the methodology described later in this footnote in "Unpaid Losses and Loss Adjustment Expenses."

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.

2. Summary of Significant Accounting Policies, continued

Investment Securities

Investment securities consist of fixed maturity debt and equity securities that the Trust intends to use as part of its asset/liability management policy and securities that may be sold in response to unexpected liquidity needs.

Investment securities are stated at fair value based, generally, on quoted market prices. Changes in the fair value of investment securities are reported as revenue. The specific identification method is used to determine the cost of securities sold. Realized and unrealized gains and losses are included in interest and investment revenue, reported within nonoperating revenue.

Cash and Cash Equivalents

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

Accounts Receivable

In accordance with GAAP 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.

Membership in NLC Mutual Insurance Company

The membership in NLC Mutual Insurance Company is carried at cost plus allocated surplus as allowed by the Department.

Equipment

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

Premium Revenue

Premiums for contracts are recognized as earned on a pro rata basis over the contract period. Advance premiums relate to premiums paid by members for insurance coverage for the subsequent insurance period. Policy coverage is matched with revenue so as to result in recognition of profits over the life of the policies through establishment of reserves for incurred claims. All policy years coincide with the Trust's fiscal year.

2. Summary of Significant Accounting Policies, continued

Unpaid Losses and Loss Adjustment Expenses

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

To reflect its present value, the liability for unpaid losses and loss adjustment expenses has been discounted at 3% for both 2019 and 2018. Discounting reduced the liability by $8,639,136 and $8,379,347 as of June 30, 2019 and 2018, respectively. The effect of discounting on the provision for losses and loss adjustment expenses was a decrease of $259,789 in 2019 and an increase of $76,424 in 2018.

Excess Insurance

Excess insurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the excess insurance contracts. Premiums, losses, and loss adjustment expenses are reported net of excess insurance amounts. The Trust evaluates the financial condition of its excess carriers to minimize its exposure to significant losses from reinsurer insolvencies. The Trust holds funds and collateral as security under excess insurance agreements in the form of letters of credit for any excess carriers not subject to the regulation of the Kentucky Commissioner of Insurance. In the opinion of management, all amounts due from excess insurance carriers at June 30, 2019 and 2018 are recoverable.

2. Summary of Significant Accounting Policies, continued

Net Position

The Board of Trustees may, at its discretion, refund to members the savings, if any, resulting from operations of the Trust in the form of dividends or reduced premiums. The amount of any future dividends or reductions in premiums is dependent on the Trust's ultimate liability for claims incurred and, accordingly, the amount may differ from the net position. No refunds were issued during 2019 or 2018.

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

Federal Income Taxes

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

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through October 18, 2019, the date that the financial statements were available to be issued.

Reclassifications

Certain amounts in the 2018 financial statements have been reclassified to conform to the 2019 presentation with no impact on total assets, total liabilities, net position, change in net position, or cash flows.

Restatement

During fiscal year ended June 30, 2019, NLC Mutual Insurance Company amended its bylaws to allow members to have access to the allocated surplus amounts, in specified circumstances, with a 180 day waiting period. As a result of the change in NLC Mutual Insurance Company's bylaws, the Trust has recorded its allocated surplus as of June 30, 2019 and restated prior periods, for comparative purposes, as described below.

For the year ended June 30, 2017, the Trust restated net assets to include previously unrecorded amounts of members' share of prior years retained surplus in NLC Mutual Insurance Company for a total change in net assets of $596,570.

2. Summary of Significant Accounting Policies, continued

Restatement, continued

For the year ended June 30, 2018 the Trust restated net assets to include previously unrecorded amounts of members' share of prior years retained surplus in NLC Mutual Insurance Company. This restatement results in the following changes:

	As Previously Reported	As Restated	Change
Membership in NLC Mutual Insurance Company	$ 242,428	$ 879,712	$ 637,284
Payable to related entities, net	422,235	421,062	(1,173)
Interest and investment revenue	1,781,534	1,780,361	(1,173)
Other income	-	70,435	70,435
Change in net position	4,433,434	4,475,321	41,887
Net position	12,202,231	12,840,688	638,457

3. Deposits and Investments

The composition of the Trust's investment portfolio must meet certain criteria as set forth in the Kentucky Administrative Regulations. Investments held by the Trust as of June 30, 2019 and 2018 are as follows:

	2019	2018
Deposits and investments classified as cash and cash equivalents:		
Cash and cash equivalents	**$ 2,779,592**	$ 4,594,173
Money market mutual funds and uninvested cash	**18,036,279**	13,812,993
	20,815,871	18,407,166
Investments classified as investment securities:		
Certificates of deposit	**3,995,805**	2,670,153
Corporate bonds	**1,781,270**	2,201,013
Municipal bonds	**13,741,734**	13,538,558
U.S. government agency obligations	**996,410**	959,200
Equity securities	**9,437,682**	9,045,841
Equity mutual funds	**5,471,844**	5,173,384
	35,424,745	33,588,149
Total deposits and investments	**$ 56,240,616**	$ 51,995,315

3. Deposits and Investments, continued

As of June 30, 2019, the Trust had the following investment maturities in years:

	Less than 1	1-5	6-10	More than 10
Certificate of deposit	$ -	$ 3,995,805	$ -	$ -
Corporate bonds	250,565	1,530,705	-	-
Municipal bonds	-	2,734,362	8,215,948	2,791,424
U.S. government agency obligations	-	996,410	-	-
Total maturities	$ 250,565	$ 9,257,282	$ 8,215,948	$ 2,791,424

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

	2019	2018
Interest and dividend income	$ 1,322,624	$ 1,089,355
Realized loss on sales of securities	(250,795)	(1,449)
Unrealized gain on securities	1,499,559	692,455
	$ 2,571,388	$ 1,780,361

Fair Value

Investments, including derivative instruments that are not hedging derivatives, are measured at fair value on a recurring basis. Recurring fair value measurements are those that GAAP requires or permits in the statement of net position at the end of each reporting period. Fair value measurements are categorized based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quotes prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

All of the Trust's investments are actively traded and categorized as Level 1 investments in the fair value hierarchy.

Credit Risk

State law and the Trust investment guidelines assert that corporate bonds are allowable if issued, assumed, or guaranteed by a solvent institution created and existing under the laws of the United States of America. They also state that corporate bond investments shall not exceed 25% of the total market value of the portfolio at the time of purchase and that the bond has a minimum rating of A.

3. Deposits and Investments, continued

Credit Risk, continued

State law and the Trust investment guidelines assert that no individual equity holding shall comprise greater than 10% of the equity portion of the portfolio at the time of purchase. Both also state that an investment in an individual holding shall not represent at the time of purchase more than 5% of the market value of the holding. Furthermore, both state that investments in equities shall not exceed 20% of the total market value of the portfolio of the self-insurance group at the time of purchase. In addition, mutual funds that are held with registered investment advisors licensed by the Securities Exchange Commission and the Commonwealth of Kentucky to perform investment services are allowable and shall not exceed 20% of the total market value of the portfolio at the time of purchase.

With respect to cash and statute defined bonds, both sets of guidelines state that, of the total investments held, no less than 50% of the total market value shall be held in cash, cash equivalents, and fixed income. Also, a minimum of 5% of the total investments shall be held in cash, cash equivalents or U.S. Treasuries and federal agency securities with a 1 year or less maturity. The Trust may also invest surplus funds or reserves not needed for current obligations in the following: U.S. government bonds, Treasury notes and T-bills or other direct obligations guaranteed by the full faith and credit of the United States of America, tax exempt obligations issued by Kentucky or its agencies with a minimum Standard and Poor (S&P) rating of A.

Furthermore, the Trust may also invest in obligations issued by a country, district, municipality or other legal authority within Kentucky with a minimum S&P rating of AA. Investments may also be made in investment share accounts in a savings and loan institution in Kentucky which is insured by the Federal Deposit Insurance Corporation. Finally, the Trust may also invest in certificates of deposit if issued by a duly chartered commercial bank.

As of June 30, 2019, the Trust was invested in government agency, municipal and corporate bonds, common stocks and mutual funds. Of these bonds that were rated, all ranged in ratings from A to AAA. The Trust also invested in money market funds that were not rated.

Concentration of Credit Risk

As of June 30, 2019, the Trust held debt and equity securities in excess of 5% of the Trust's total investments issued by the following issuers: Kentucky Property and Building Commission (6.4%) and the Kentucky State Turnpike Authority (6.0%).

Custodial Credit Risk - Deposits

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

4. Excess Insurance

For the years ended June 30, 2019 and 2018, respectively, the Trust purchased specific excess insurance coverage from Safety National, an "A+" (Superior) rated insurer rated by A.M. Best and Company, for the excess layer of insurance only to cover losses in excess of $1,500,000 (retention). The Trust must self-insure up to the retention per occurrence limits. For 2019 and 2018, employer's liability loss limitations were $4,000,000 (retention of $1,500,000 plus $2,500,000 of excess insurance). For the years ended June 30, 2019 and 2018, respectively, the Trust purchased specific excess insurance coverage from NLC Mutual Insurance Company for the excess layer of insurance only to cover 50% of $500,000 in loss in excess of $1,000,000 (retention). The Trust must self-insure up to retention limits per occurrence.

Although the purchase of excess insurance coverage does not discharge the Trust from its primary liability to its members, the excess insurance carrier that assumes the coverage assumes the related liability, and it is the practice of organizations such as the Trust for accounting purposes to treat insured risks, to the extent of excess insurance coverage, as though they were risks for which the Trust is not liable. However, the Trust remains contingently liable in the event its excess insurance carriers are unable to meet their contractual obligations.

Excess insurance premiums ceded for the years ended June 30, 2019 and 2018 were $1,041,508 and $1,217,706, respectively. Additional recoveries accrued on paid claims during 2019 and 2018 were $537,508 and $624,252, respectively. The liability for unpaid losses and loss adjustment expenses has been reduced to reflect excess insurance recoverables on policy case reserves and estimated recoverables on claims incurred but not reported by $20,798,183 and $18,408,181 in 2019 and 2018, respectively.

5. Security Deposit

To satisfy requirements of the Department, the Trust maintains a security deposit account held under safekeeping with a bank in the amount of approximately $4.4 million as of June 30, 2019.

6. Related Party Transactions

The following are related entities of the Trust:

Kentucky Bond Corporation (KBC)
Kentucky Bond Development Corporation (KBDC)
Kentucky League of Cities (KLC)
Kentucky League of Cities Funding Trust (KLCFT)
Kentucky League of Cities Insurance Agency (KLCIA)
Kentucky League of Cities Insurance Services Association (KLCIS)
Kentucky League of Cities Investment Pool (KLCIP)
Kentucky League of Cities Premium Finance Company (KLCPFC)
Kentucky League of Cities Unemployment Compensation Reimbursement Trust (KLCUCRT)
Kentucky Local Government Health Trust (KLGHT)

6. Related Party Transactions, continued

The Trust was organized by KLC at the request of the state municipalities. KLC provides substantially all of the Trust's operational, management and administrative services in exchange for an administrative fee based on allocated costs plus a percentage of earned premiums. Total administrative fees under the agreement amounted to $1,834,014 and $1,777,823 for the years ended June 30, 2019 and 2018, respectively.

The Trust participates in a marketing agreement with KLCIA which provides that the Trust pay a commission for member accounts marketed or serviced by KLCIA. Commission expense under the agreement was $311,497 and $325,549 for the years ended June 30, 2019 and 2018, respectively.

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

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

	2019	2018
KLC accounts receivable (payable)	**$ 23,315**	$ (24,714)
KLCIS accounts payable	**(1,307,013)**	(396,348)
KLCIA accounts payable	**(4,269)**	-
Net payable to related entities	**$ (1,287,967)**	$ (421,062)

7. Liability for Unpaid Losses and Loss Adjustment Expenses

Activity in the liability for unpaid losses and loss adjustment expenses for the years ended June 30, 2019 and 2018 is summarized as follows:

	2019	2018
Net unpaid losses and loss adjustment expenses, beginning of year	**$ 38,749,870**	$ 38,466,979
Incurred losses and loss adjustment expenses:		
Provision for insured events of the current year	**10,518,000**	10,024,000
Decrease in provision for insured events of prior years	**(947,001)**	(1,529,900)
Total incurred losses and loss adjustment expenses	**9,570,999**	8,494,100
Payments:		
Losses and loss adjustment expenses attributable to insured events of the current year	**2,498,948**	1,979,853
Losses and loss adjustment expenses attributable to insured events of prior years	**5,675,687**	6,231,356
Total payments	**8,174,635**	8,211,209
Net unpaid losses and loss adjustment expenses, end of year	**$ 40,146,234**	$ 38,749,870

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

8. Surplus Note Agreements

At the direction and approval of the Department, on January 6, 2010, the Trust loaned $5,500,000 to Kentucky School Boards Insurance Trust (KSBIT) for its workers' compensation fund and loaned $2,500,000 to KSBIT for its property and liability self-insurance fund, which was evidenced by two surplus notes. Interest on the notes was due quarterly until the notes were paid in full. Interest was calculated at a rate per annum which shall equal the sum of the year to date yield on the S&P Index weighted at 20% plus the year to date yield on the Bar Cap Index weighted at 80%. Provided, however, in no event shall the annual interest rate be less than 1% or greater than 5%.

At the time the Trust made the loans to KSBIT, the Department stated to the Trust, KLC and KSBIT that, to the extent that KSBIT was unable to generate a surplus from operating the self-insurance funds sufficient to repay the loans, KSBIT would be required to assess its members to repay the loans. In late September 2013, the Department changed its position and indicated that it does not believe an assessment should include the repayment of the $8,000,000 loans to the Trust. The Trust disagreed with the Department and filed a Declaratory Action against the Department on November 5, 2013 seeking a determination that assessments for the KSBIT funds must include assessments for all fund obligations including the loans evidenced by the

8. Surplus Note Agreements, continued

surplus notes, or in the alternative, that the Commissioner of Insurance in her capacity as Rehabilitator for the KSBIT funds, should be liable for the amount of the notes on the grounds of negligent misrepresentation, estoppel and equity. On October 27, 2015, the circuit court issued an opinion and order ruling that the loans did not have to be repaid through an assessment and ordered the refund of any interest that has been previously paid on the loans. The court noted that "this is a case of first impression in Kentucky," which means that there is no reported Kentucky appellate decision on the unique issues involved. In addition, since this was a review of a summary judgment, the appellate court will conduct a full analysis of the merits and equities without having to give deference to the circuit court. Accordingly, the Trust appealed that decision to the Kentucky Court of Appeals. The filing of the appeal by the Trust stayed the circuit court's decision during the appeal period. The appellate process could take years depending upon whether or not the case would eventually get heard by the Kentucky Supreme Court.

On December 14, 2016, an Agreed Judgment was signed relating to the above litigation. According to the settlement, the Trust was awarded $4,000,000 in principal payments, the interest that was due to the Trust on December 31, 2016 was not to be paid and in turn, the Trust did not have to repay the $1,292,877 of interest previously received. Due to the uncertain nature of future payments, the Trust chose to allow for the entire remaining receivable due under the settlement as of June 30, 2017. During the year ended June 30, 2018, the Trust recorded $2,455,000 in principal payments received on the KSBIT settlement.

DEANDORTON

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*

Report of Independent Auditors

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Kentucky League of Cities Workers' Compensation Trust (the Trust), which comprise the statement of net position as of June 30, 2019, and the related statement of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 18, 2019.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

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

Purpose of this Report

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

Dean Dorton Allen Ford, PLLC

Lexington, Kentucky
October 18, 2019

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Schedule of Findings and Responses

Year ended June 30, 2019

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: **None reported**

d. Noncompliance which is material to the financial statements: **No**

Section II - Summary of Findings and Responses

None

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Claims Development Information (*Unaudited*)

Years ended June 30, 2010 through 2019

The following table illustrates how the Trust's earned premium revenue (net of excess insurance) and investment income compare to related costs of loss (net of loss assumed by excess insurance carriers) and other expenses assumed by the Trust 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 excess insurance carriers, and net earned premium revenue and reported investment revenue. (2) This line shows each fiscal year's other operating costs of the Trust including overhead and claims expense not allocable to individual claims. (3) This line shows the Trust's gross incurred claims and allocated claims adjustment expenses, claims assumed by excess insurance carriers, 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 excess insurance carriers as of the end of the current year for each accident year. (6) This section shows how each policy year's net incurred claims increased or decreased as of the end of successive years. (This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, and emergence of new claims not previously known.) (7) This line compares the latest reestimated net incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of net claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts commonly is used to evaluate the accuracy of net incurred claims currently recognized in less mature policy years. The columns of the table show data for successive policy years.

						Fiscal and Policy Year Ended					
		2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
(1)	Earned premium revenue and net investment income:										
	Earned	$ 18,454,798	$ 16,853,253	$ 14,003,578	$ 11,855,839	$ 15,587,040	$ 13,442,044	$ 14,792,894	$ 14,211,303	$ 15,341,744	$ 16,498,198
	Ceded	1,368,978	847,592	738,366	784,959	881,546	880,281	851,810	1,168,123	1,217,706	1,041,508
	Net earned	17,085,820	16,005,661	13,265,212	11,070,880	14,705,494	12,561,763	13,941,084	13,043,180	14,124,038	15,456,690
(2)	Unallocated expenses	3,435,931	4,161,830	3,675,218	4,027,265	4,113,508	3,311,946	3,180,640	3,158,843	3,237,164	3,399,535
(3)	Estimated incurred claims and expenses, end of policy year:										
	Incurred	9,300,000	9,280,000	8,396,000	8,870,000	11,157,746	13,307,585	10,285,000	9,782,000	10,024,000	10,518,000
	Ceded	-	-	-	-	237,746	551,585	-	-	-	-
	Net incurred	9,300,000	9,280,000	8,396,000	8,870,000	10,920,000	12,756,000	10,285,000	9,782,000	10,024,000	10,518,000
(4)	Net paid (cumulative) as of:										
	End of policy year	2,173,724	2,412,348	2,166,759	1,903,747	2,663,585	3,458,053	2,195,901	2,257,199	1,979,853	2,498,948
	One year later	4,267,533	4,305,129	4,210,478	4,142,789	5,318,318	6,577,293	4,287,792	4,743,216	4,125,253	
	Two years later	5,408,939	5,734,677	5,496,361	5,232,100	7,558,252	8,507,865	5,333,555	6,270,521		
	Three years later	5,826,064	6,655,741	6,056,594	6,061,691	8,966,855	9,305,850	5,703,226			
	Four years later	5,980,736	7,749,815	6,918,166	6,290,380	9,379,836	9,612,115				
	Five years later	6,205,615	8,423,345	7,137,799	6,437,849	9,638,012					
	Six years later	6,445,708	8,955,496	7,434,319	6,560,566						
	Seven years later	6,500,829	9,269,812	7,572,347							
	Eight years later	6,752,075	9,341,224								
	Nine years later	6,793,478									
(5)	Reestimated ceded claims and expenses	-	-	1,062,389	809,468	268,362	258,624	413,863	-	-	-
(6)	Reestimated net incurred claims and expenses:										
	End of policy year	9,300,000	9,280,000	8,396,000	8,870,000	10,920,000	12,756,000	10,285,000	9,782,000	10,024,000	10,518,000
	One year later	9,000,000	8,770,000	8,700,000	9,240,000	11,313,000	13,701,000	9,517,000	10,849,000	11,338,000	
	Two years later	8,360,000	9,730,000	9,390,000	10,188,000	12,343,000	13,643,000	9,099,000	10,345,000		
	Three years later	8,525,000	10,380,000	11,253,000	9,415,000	13,117,000	12,650,000	8,688,000			
	Four years later	8,490,000	11,284,000	10,425,000	8,793,000	12,443,000	11,893,000				
	Five years later	8,381,000	11,156,000	10,679,000	9,223,000	12,487,437					
	Six years later	8,161,000	11,135,000	10,933,086	9,033,983						
	Seven years later	8,042,000	11,019,366	10,705,504							
	Eight years later	7,773,568	10,934,859								
	Nine years later	7,860,894									
(7)	Increase (decrease) in estimated net incurred claims and expenses from the end of the policy year	(1,439,106)	1,654,859	2,309,504	163,983	1,567,437	(863,000)	(1,597,000)	563,000	1,314,000	-

See report of independent auditors.