KENTUCKY ASSOCIATION OF COUNTIES - ALL LINES FUND

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

Years Ended June 30, 2010 and 2009

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DMLO
DEMING MALONE
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CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Kentucky Association of Counties - All Lines Fund
Frankfort, Kentucky

We have audited the accompanying balance sheets of Kentucky Association of Counties - All Lines Fund as of June 30, 2010 and 2009, and the related statements of revenues, expenses and changes in members' equity and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Association of Counties - All Lines Fund as of June 30, 2010 and 2009 and changes in members' equity and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deming, Malone, Livesay & Ostroff

Louisville, Kentucky
October 28, 2010

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KENTUCKY ASSOCIATION OF COUNTIES - ALL LINES FUND

BALANCE SHEETS
June 30, 2010 and 2009

ASSETS	2010	2009
Cash and cash equivalents	$ 6,122,924	$ 19,253,979
Investments, at fair market value	53,987,468	40,353,292
Member premiums receivable	27,392,578	26,513,300
Accrued interest receivable	264,217	253,489
Other	251,660	277,300
Total assets	$ 88,018,847	$ 86,651,360

LIABILITIES AND MEMBERS' EQUITY		
Estimated liability for future claims, net of estimated recoveries:		
Reported claims	$ 16,600,000	$ 13,920,000
Claims incurred but not reported	20,300,000	21,780,000
	36,900,000	35,700,000
Unallocated loss adjustment expenses	183,000	176,000
Dividend payable	2,998,310	
Deferred revenue	28,786,326	28,620,410
Accounts payable	263,030	307,308
Total liabilities	69,130,666	64,803,718
MEMBERS' EQUITY	18,888,181	21,847,642
Total liabilities and members' equity	$ 88,018,847	$ 86,651,360

See Notes to Financial Statements.

KENTUCKY ASSOCIATION OF COUNTIES -
ALL LINES FUND

STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN MEMBERS' EQUITY
Years Ended June 30, 2010 and 2009

	2010	2009
REVENUES		
Member premiums	$ 28,770,436	$ 29,413,023
Investment income	1,696,728	2,025,128
Realized and unrealized gain (loss) on investments	1,043,318	(919,796)
Total revenues	31,510,482	30,518,355
EXPENSES		
Claims expense, net of recoveries	18,652,174	17,295,017
Reinsurance premiums	7,199,595	6,806,650
Administration and marketing	4,281,334	4,091,574
Professional fees	484,682	149,287
Management expense	853,848	588,757
Total expenses	31,471,633	28,931,285
Excess of revenues over expenses before distributions to members	38,849	1,587,070
NET DISTRIBUTIONS TO MEMBERS	(2,998,310)	
(Decrease) increase in members' equity	(2,959,461)	1,587,070
Members' equity, beginning of year	21,847,642	20,260,572
Members' equity, end of year	$ 18,888,181	$ 21,847,642

See Notes to Financial Statements.

KENTUCKY ASSOCIATION OF COUNTIES -
ALL LINES FUND

STATEMENTS OF CASH FLOWS
Years Ended June 30, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Cash received from member premiums	$ 28,057,074	$ 30,312,870
Reinsurance and other recoveries collected	369,387	9,895,362
Cash paid to suppliers	(12,831,097)	(11,544,504)
Claims paid	(17,821,561)	(23,842,160)
Investment income received	1,686,000	2,130,824
Net cash (used in) provided by operating activities	(540,197)	6,952,392
Cash flows from investing activities:		
Purchase of investments	(29,875,492)	(16,664,293)
Proceeds from sale of investments	17,284,634	19,986,053
Net cash (used in) provided by investing activities	(12,590,858)	3,321,760
Net (decrease) increase in cash and cash equivalents	(13,131,055)	10,274,152
Cash and cash equivalents at beginning of year	19,253,979	8,979,827
Cash and cash equivalents at end of year	$ 6,122,924	$ 19,253,979

SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES

In August 2009, the Board of Trustees of the Fund declared a $2,998,310 dividend for the policy year ended June 30, 2006 payable to its eligible members, pursuant to the Fund's By-Laws and all other applicable provisions, in July 2010.

See Notes to Financial Statements.

	2010	2009
RECONCILIATION OF EXCESS OF REVENUES OVER EXPENSES TO NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES		
Excess of revenues over expenses	$ 38,849	$ 1,587,070
Adjustments to reconcile excess of revenues over expenses to net cash (used in) provided by operating activities:		
Realized and unrealized (gains) losses on investments	(1,043,318)	919,796
Changes in assets and liabilities:		
Decrease (increase) in:		
Member premiums receivable	(879,278)	1,649,514
Reinsurance receivable		3,048,219
Accrued interest receivable	(10,728)	105,696
Other	25,640	(23,440)
Increase (decrease) in:		
Estimated liability for future claims	1,200,000	300,000
Unallocated loss adjustment expense	7,000	16,000
Deferred revenue	165,916	(749,667)
Accounts payable	(44,278)	99,204
Total adjustments	(579,046)	5,365,322
Net cash (used in) provided by operating activities	$ (540,197)	$ 6,952,392

KENTUCKY ASSOCIATION OF COUNTIES - ALL LINES FUND

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Business and Summary of Significant Accounting Policies

Nature of business:

The Kentucky Association of Counties-All Lines Fund (Fund) is for the purpose of assisting its participants as defined by KRS 65.230, to formulate, develop and administer a program of self-insurance or partial self-insurance for the Fund participants to obtain lower cost of various types of insurance coverage, provide excess insurance coverage for the participants, and develop a comprehensive safety program. The Fund arranges to provide necessary administrative and legal services sufficient to meet the participants' obligations under Kentucky Law. All funds or monies held by the Fund are the property of the public agencies or political subdivisions participating in the Fund and the Fund shall be an instrumentality of the participating public agencies and only execute essential governmental functions. It is the intent of the participants in the Fund to create an entity with a pool and use funds contributed by the members against stated liability or loss to the limits of the financial resources of the Fund as specifically outlined in coverage agreements provided to the various participants. The Fund operates solely for the mutual and exclusive benefit of its members as a non-profit entity. The Fund's participants consisted of 112 counties and 581 political subdivisions for 2010.

Summary of significant accounting policies:

This summary of significant accounting policies of the Fund is presented to assist in understanding the Fund's financial statements. The financial statements are representations of the Fund's management who is responsible for the integrity and objectivity of the financial statements. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the financial statements.

Method of accounting:

The financial statements of the Fund have been prepared on the accrual basis of accounting.

NOTES TO FINANCIAL STATEMENTS

Investments:

The fund records all investments at fair market value. Fair value is established based upon readily determinable market quotations for equity and debt securities.

The Fund has significant investments in mutual funds, common stocks, government securities, and corporate bonds held by Central Bank & Trust Company and FSC Securities Corporation. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Because of the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the balance sheet.

Revenue and expense recognition:

Member premiums revenue is recognized over the period to which the insurance coverage relates. Deferred revenue represents member premiums billed but not yet earned.

Fund expenses for reinsurance premiums, management and marketing fees and royalties are expensed ratably over the period of coverage.

Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

A significant estimate in these financial statements is the estimated liability for future claims (see Note 5).

NOTES TO FINANCIAL STATEMENTS

Cash and cash equivalents:

For purposes of the statement of cash flows, the Fund considers only cash and investments with an original maturity of three months or less to be cash and cash equivalents.

Allowance for uncollectible accounts:

As of June 30, 2010 and 2009, substantially all of the member premiums receivable consist of advance billings on the next year's premiums and is also included in deferred revenue. Any member premiums receivable for the current or prior years are reviewed by management and evaluated for collectability. No provision for doubtful accounts has been made at June 30, 2010 and 2009, as management considers all amounts fully collectible.

Income taxes:

The Fund is exempt from income taxes under Section 115 of the Internal Revenue Code. However, income from certain activities not directly related to the Fund's tax-exempt purpose may be subject to taxation as unrelated business income.

On July 1, 2009, the Fund adopted new guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions in an organization's financial statements. Income tax positions must meet a more-likely than not recognition threshold to be recognized. The adoption of this guidance did not have an effect on the Fund's financial position and results of operations.

As of June 30, 2010 and 2009, the Fund did not have any accrued interest or penalties related to income tax liabilities, and no interest or penalties have been charged to operations for the years then ended. Tax years still open under federal and state statute of limitations remain subject to review and change.

Reinsurance:

The Fund uses reinsurance agreements to reduce its exposure to large losses on all types of insured events. Reinsurance permits recovery of a portion of losses from reinsurers, although it does not discharge the primary liability of the Fund as direct insurer of the risks reinsured. The Fund does not report reinsured risks as liabilities unless it is probable that those risks will not be covered by the reinsurer.

Legal, regulatory and geographic risk:

Legal and regulatory risk is the risk that changes in the legal or regulatory environment in which an insurer operates will occur and create additional losses or expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits or new legal theories may create costs for the insurer beyond those currently recorded in the financial statements. The Fund 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.

Geographic risk is the risk that catastrophic losses will occur in one concentrated area where the Fund does business. The Fund mitigates this risk by adhering to specified underwriting practices and by obtaining adequate reinsurance coverage.

Subsequent event:

Subsequent events have been evaluated through October 28, 2010, which is the date the financial statements were available to be issued.

Note 2. Investments

Investments are carried at fair market value as determined based on quoted prices in active markets. Investments held in trust funds by Central Bank & Trust Company and FSC Securities Corporation at June 30, 2010 consisted of the following:

NOTES TO FINANCIAL STATEMENTS

	Face Value	Cost	Fair Market Value
Mortgage-Backed Securities:			
Federal Home Loan Bank	$ 9,845,000	$ 9,866,439	$ 10,065,228
Federal Home Loan Mortgage	1,500,000	1,500,000	1,523,595
FNMA	16,500,000	16,496,165	16,670,196
Federal Farm Credit Banks	3,000,000	3,000,000	3,042,180
	30,845,000	30,862,604	31,301,199
Corporate bonds	5,750,000	5,833,303	6,231,105
Common stocks		6,956,219	6,048,067
Mutual funds		9,376,230	9,420,799
Municipal bonds		691,871	737,444
Other investments		324,126	248,854
Total investments		$54,044,353	$53,987,468

Investments held in trust funds by Central Bank & Trust Company and FSC Securities Corporation at June 30, 2009 consisted of the following:

	Face Value	Cost	Fair Market Value
Mortgage-Backed Securities:			
Federal Home Loan Bank	$ 6,500,000	$ 6,509,489	$ 6,562,045
Federal Home Loan Mortgage	5,000,000	5,000,000	5,087,850
FNMA	8,200,000	8,196,478	8,160,951
Federal Farm Credit Banks	2,500,000	2,501,605	2,451,100
	22,200,000	22,207,572	22,261,946
Corporate bonds	5,750,000	5,819,903	5,881,800
Common stocks		4,696,388	3,865,156
Mutual funds		8,520,506	8,225,398
Other investments		144,561	118,992
Total investments		$41,388,930	$40,353,292

The aggregate annual maturities of the fair market value of investments at June 30, 2010, based upon stated maturity dates are as follows:

Due within one to five years	$13,714,871
Due within five to ten years	24,554,877
Common stocks	6,048,067
Mutual funds	9,420,799
Other investments	248,854
	$53,987,468

Note 3. Fair Value Measurements

Accounting principles generally accepted in the United States of America establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described as follows:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Fund has the ability to access.

Level 2 – Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active or inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in methodologies used at June 30, 2010.

Mutual funds – valued at the net asset value of shares held by the Fund at year end.

NOTES TO FINANCIAL STATEMENTS

Common stock, corporate bonds, municipal bonds, other investments and U.S. government securities – valued at the closing price reported on the active market on which the individual securities are traded.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Fund believes their valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth, by level, within the fair value hierarchy, the Fund's assets at fair value as of June 30, 2010 and 2009:

	June 30, 2010 Level 1	June 30, 2009 Level 1
U.S. government securities	$31,301,199	$22,261,946
Mutual funds:		
Bond fund	8,229,743	7,666,026
International fund	486,233	246,061
Mid cap fund	192,424	
Precious metals fund	271,079	116,777
Small cap fund	241,320	196,534
Corporate bonds	6,231,105	5,881,800
Common stocks:		
Basic materials	946,965	570,917
Consumer goods	316,735	225,331
Financial	938,923	787,026
Healthcare	470,975	333,299
Industrial goods	979,196	476,191
Other	43,260	35,160
Services	713,766	399,732
Technology	1,427,848	964,716
Utilities	210,399	72,784
Municipal bonds	737,444	
Other investments	248,854	118,992
Total assets at fair value	$53,987,468	$40,353,292

Note 4. Other Assets

	2010	2009
Prepaid management fee	$ 201	$ 422
Prepaid building maintenance	7,500	10,500
Prepaid administrative fees	155,797	134,135
Prepaid loss control	88,162	132,243
	$251,660	$277,300

Note 5. Estimated Unpaid Claims Liabilities

Under Kentucky Law, the Fund is required to pay all valid claims against its members.

The estimated liability for future claims, net of estimated recoveries for reinsurance, deductibles and subrogation was determined by Fund management as a result of consultation with the Fund's actuaries, Oliver Wyman Actuarial Consulting, Inc. and By The Numbers Actuarial Consulting, Inc. for the years ended June 30, 2010 and 2009.

The actuaries provide a range of the estimated liability for unpaid claims. Management selects an amount in that range which they believe represents a reasonable estimate of the ultimate liability. This estimate is based upon various factors such as loss control efforts, claim trends and historical claims information.

To the extent that claims information varies from management's estimates, the statement of revenues, expenses and changes in members' equity reflect adjustments in the year they occur.

For each of the years ended June 30, 2010 and 2009, the liability selected by management was the mid-range or "best estimate" as determined by the actuaries and was discounted at 5.0%, based upon an estimate of the Fund's yield on its investments and expected claims payment patterns as developed by the actuaries. The loss payment pattern used could vary significantly from actual which would have a direct effect on the liability for estimated claims. The liability, without consideration for the time value of money for 2010 and 2009, respectively, was approximately $41,400,000 and $40,000,000.

The Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities, net of recoveries, for the years ended June 30, 2010 and 2009:

	2010	2009
Unpaid claims and claim adjustment expenses at beginning of year	$35,700,000	$35,400,000
Reinsurance and deductibles receivable on paid claims at beginning of year		(3,048,219)
	35,700,000	32,351,781
Incurred claims and claim adjustment expenses:		
Provision for insured events of current year and increases in provision for insured events of prior years net of recoveries	18,652,174	17,295,017
Payments:		
Claim and claim adjustment expenses paid attributable to insured events of current and prior years net of recoveries collected	(17,452,174)	(13,946,798)
Unpaid claims and claim adjustment expenses at end of year	$36,900,000	$35,700,000

Note 6. Unallocated Loss Adjustment Expenses

An estimated liability for future expenses of handling prior year claims has been determined by management and the Fund's actuaries as of June 30, 2010 and 2009, and recorded as unallocated loss adjustment expenses.

Note 7. Concentration of Credit Risk

The Fund maintains its cash accounts at various banks in Kentucky. Accounts at each bank are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. At June 30, 2010, the uninsured cash balances totaled approximately $6,500,000.

Note 8. Related Party Transactions

The Fund purchases employee dishonesty fidelity bond coverage and business income/extra expense coverage from Commonwealth Insurance Company, Inc., which is a wholly owned subsidiary of Kentucky Association of Counties Leasing Trust (COLT) and a related party of KACo. Expense for the years ended June 30, 2010 and 2009 was $924,192 and $904,040 respectively.

The Fund is under a Program Administration Agreement with KACo in which the Fund reimburses KACo for certain management and administrative expenses. Total fees for the years ended June 30, 2010 and 2009 were $1,347,376 and $1,391,365, respectively. As of June 30, 2010 and 2009, the Fund had prepaid administrative fees of $155,797 and $134,135, respectively.

The Fund is under a Program Administration Agreement with KACo in which the Fund pays KACo for certain management services. The fee is based on 2% of earned premiums collected. For the year ended June 30, 2010, the agreement included a base management fee of $279,000 in addition to the 2% of earned premiums collected. Total fees for the years ended June 30, 2010 and 2009 were $852,848 and $587,757, respectively. As of June 30, 2010 and 2009, the Fund had a prepaid of $201 and $422, respectively.

The Fund has a licensing agreement with KACo that requires the Fund to pay a royalty to KACo in return for the use of KACo's name and logo. For the year ended June 30, 2010 and 2009, the royalty was a fixed amount of $1,000.

KACo established the Kentucky Association of Counties Program Guaranty Fund. The purpose of the Guaranty Fund is to make available, on an as needed basis, financial support to the various programs sponsored by and operating under service agreements with KACo, which includes the Fund. The Guarantee Fund receives contributions from KACo and certain of its programs. The Fund did not make any contributions to the Guaranty Fund for the years ended June 30, 2010 or 2009.

INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTARY INFORMATION

To the Board of Trustees
Kentucky Association of Counties - All Lines Fund
Frankfort, Kentucky

The ten-year claims development information on page 16 is not a required part of the basic financial statements of the Kentucky Association of Counties - All Lines Fund but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Deming, Malone, Livesay & Ostroff

Louisville, Kentucky
October 28, 2010

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KENTUCKY ASSOCIATION OF COUNTIES - ALL LINES FUND

TEN-YEAR CLAIMS DEVELOPMENT INFORMATION

Fiscal and Policy Year Ended (In Thousands of Dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1. Premiums and investment revenue:										
Earned	$ 10,544	$ 12,524	$ 18,260	$ 21,770	$ 25,556	$ 29,793	$ 33,359	$ 31,074	$ 30,518	$ 31,510
Ceded	1,840	3,081	4,664	4,975	5,693	5,535	6,160	6,068	6,800	7,200
Net earned	8,704	9,443	13,596	16,795	19,863	24,258	27,199	25,006	23,718	24,310
2. Unallocated expenses	1,930	1,835	2,661	2,599	3,143	3,730	4,107	4,240	4,829	5,620
3. Estimated losses and expenses, end of policy year:										
Incurred	9,975	12,500	17,950	15,060	17,620	14,303	17,049	20,364	20,049	20,509
Ceded	(1,923)	(1,791)	(5,950)	(1,390)	(2,300)	-	(284)	-	(5)	(505)
Net incurred	8,052	10,709	12,000	13,670	15,320	14,303	16,765	20,364	20,054	20,004
4. Net paid (cumulative) as of:										
End of policy year	1,445	1,960	2,860	3,197	3,438	3,475	3,595	5,165	6,976	4,378
One year later	2,587	3,267	5,472	6,407	6,065	6,105	5,456	10,082	11,114	
Two years later	3,613	4,870	7,154	8,869	8,193	7,973	8,214	14,320		
Three years later	4,485	6,404	11,145	9,231	9,220	9,377	9,987			
Four years later	5,257	9,637	11,954	10,618	10,383	10,149				
Five years later	7,532	9,996	13,262	10,822	10,727					
Six years later	7,756	10,360	13,086	10,888						
Seven years later	7,756	10,085	13,107							
Eight years later	7,759	10,093								
Nine years later	7,759									
* 5. Reestimated ceded losses and expenses	1,722	4,587	8,403	2,892	29	81	2,040	4,865	-	505
** 6. Reestimated net incurred losses and expenses:										
End of policy year	8,052	10,709	12,000	13,670	15,320	14,303	16,765	20,364	20,054	20,004
One year later	7,116	10,912	14,040	14,000	13,549	13,566	14,710	20,222	20,542	
Two years later	7,311	10,580	14,020	13,379	13,349	13,398	13,555	21,568		
Three years later	7,861	10,704	13,777	12,284	12,408	12,848	13,724			
Four years later	7,877	10,560	13,974	12,308	12,533	12,032				
Five years later	7,905	10,627	14,370	11,778	12,188					
Six years later	7,919	10,741	13,712	11,637						
Seven years later	7,878	10,310	13,294							
Eight years later	7,829	10,236								
Nine years later	7,781									
7. Increase (decrease) in estimated net incurred losses and expenses from end of accident year	(271)	(473)	1,294	(2,033)	(3,132)	(2,272)	(3,041)	1,204	488	

* Includes paid loss and ALAE plus nominal case reserves excess of retention (does not include a provision for IBNR).
** Includes unpaid loss and ALAE discounted at 5.0%.