

Kentucky Association of Counties, Inc. and Subsidiaries
Consolidated Financial Statements
Years Ended June 30, 2012 and 2011

Kentucky Association of Counties, Inc. and Subsidiaries

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June 30, 2012 and 2011

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Independent Auditor's Report on Financial Statements

To the Board of Directors

Kentucky Association of Counties, Inc. and Subsidiaries

We have audited the accompanying consolidated statements of financial position of Kentucky Association of Counties, Inc. and Subsidiaries ("the Organization") as of June 30, 2012 and 2011 and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Organization's management. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Association of Counties, Inc. and Subsidiaries as of June 30, 2012 and 2011, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The supplementary information on pages 15-19 is presented for the purpose of additional analysis and is not a required part of the basic consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

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October 24, 2012

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Kentucky Association of Counties, Inc. and Subsidiaries
Consolidated Statements of Financial Position
June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 5,501,592	\$ 5,260,648
Accounts receivable	47,324	77,737
Due from related parties	246,381	291,451
Assets held for sale	927,140	927,140
Note receivable, current portion	47,093	-
Prepaid expenses	33,892	37,844
	<hr/>	<hr/>
Total Current Assets	6,803,422	6,594,820
Property and equipment, net	12,009,107	12,701,597
Note receivable, net of current portion	204,782	-
Deferred tax asset	-	46
Restricted cash	-	5,999
	<hr/>	<hr/>
Total Assets	<u>\$ 19,017,311</u>	<u>\$ 19,302,462</u>
Liabilities and Net Assets		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 144,522	\$ 132,842
Accrued compensated absences	358,252	321,974
Accrued income taxes	4,873	16,443
Unearned revenues	802,225	843,648
Current portion of capital lease obligations	24,938	22,809
Current portion of related party loan	494,840	479,893
	<hr/>	<hr/>
Total Current Liabilities	1,829,650	1,817,609
Capital lease obligations, net of current portion	11,596	26,629
Related party loan, net of current portion	7,416,019	8,452,475
	<hr/>	<hr/>
Total Liabilities	9,257,265	10,296,713
Net Assets		
Unrestricted		
Board designated - program guarantee fund	750,000	500,000
Undesignated	8,587,837	8,083,540
	<hr/>	<hr/>
Total unrestricted	9,337,837	8,583,540
Temporarily restricted	422,209	422,209
	<hr/>	<hr/>
Total Net Assets	9,760,046	9,005,749
	<hr/>	<hr/>
Total Liabilities and Net Assets	<u>\$ 19,017,311</u>	<u>\$ 19,302,462</u>

See accompanying notes.

Kentucky Association of Counties, Inc. and Subsidiaries
Consolidated Statements of Activities and Changes in Net Assets
Years Ended June 30, 2012 and 2011

	2012			2011		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
Revenues, Gains and Other Support						
Program administration fees	\$ 3,734,768	\$ -	\$ 3,734,768	\$ 3,816,661	\$ -	\$ 3,816,661
Management fees	2,816,914	-	2,816,914	2,712,357	-	2,712,357
Advisory fees	296,712	-	296,712	-	-	-
License fees	5,000	-	5,000	5,000	-	5,000
Public official bond revenue	403,986	-	403,986	377,719	-	377,719
Commissions - other	619,401	-	619,401	621,598	-	621,598
Membership dues	185,450	-	185,450	152,950	-	152,950
Training session fees	54,215	-	54,215	40,820	-	40,820
Interest income	50,533	-	50,533	90,468	-	90,468
Rental income	47,250	-	47,250	35,610	-	35,610
Endorsement and marketing fees	38,285	-	38,285	77,687	-	77,687
KACo convention, net	22,579	-	22,579	19,626	-	19,626
Gain on disposal of fixed assets	7,400	-	7,400	4,000	-	4,000
Miscellaneous	4,369	-	4,369	508	-	508
	<u>8,286,862</u>	<u>-</u>	<u>8,286,862</u>	<u>7,955,004</u>	<u>-</u>	<u>7,955,004</u>
Expenses						
Program services	5,754,080	-	5,754,080	5,392,110	-	5,392,110
Supporting services	1,690,475	-	1,690,475	1,646,411	-	1,646,411
Interest expense	42,165	-	42,165	4,439	-	4,439
Provision for income taxes	45,845	-	45,845	75,500	-	75,500
	<u>7,532,565</u>	<u>-</u>	<u>7,532,565</u>	<u>7,118,460</u>	<u>-</u>	<u>7,118,460</u>
Changes in Net Assets	754,297	-	754,297	836,544	-	836,544
Net Assets at Beginning of Year	<u>8,583,540</u>	<u>422,209</u>	<u>9,005,749</u>	<u>7,746,996</u>	<u>422,209</u>	<u>8,169,205</u>
Net Assets at End of Year	<u>\$ 9,337,837</u>	<u>\$ 422,209</u>	<u>\$ 9,760,046</u>	<u>\$ 8,583,540</u>	<u>\$ 422,209</u>	<u>\$ 9,005,749</u>

See accompanying notes.

Kentucky Association of Counties, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities		
Changes in net assets	\$ 754,297	\$ 836,544
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Benefit from deferred income taxes	46	18,136
Bad debt expense	-	100,721
Depreciation	732,919	757,843
Gain on sale of property and equipment	(7,400)	(4,000)
Changes in:		
Accounts receivable	30,413	(57,818)
Due from related parties	45,070	(291,451)
Accrued interest	(1,875)	-
Prepaid expenses	3,952	21,581
Accounts payable and accrued liabilities	58,045	(16,339)
Accrued compensated absences	36,278	61,118
Unearned revenues	(41,423)	(192,754)
Net Cash Provided by Operating Activities	1,610,322	1,233,581
Cash Flows from Investing Activities		
Purchases of property and equipment	(86,639)	(455,377)
Proceeds from sale of property and equipment	7,400	4,000
Decrease in restricted cash	5,999	345,313
Issuance of note receivable	(250,000)	-
Net Cash Used by Investing Activities	(323,240)	(106,064)
Cash Flows from Financing Activities		
Payments on capital lease obligation	(24,629)	(22,667)
Principal payments on related party loan	(1,021,509)	(1,972,632)
Net Cash Used by Financing Activities	(1,046,138)	(1,995,299)
Increase (Decrease) in Cash and Cash Equivalents	240,944	(867,782)
Cash and Cash Equivalents at Beginning of Year	5,260,648	6,128,430
Cash and Cash Equivalents at End of Year	<u>\$ 5,501,592</u>	<u>\$ 5,260,648</u>
Supplemental Disclosure:		
Cash paid for interest	\$ 42,922	\$ 60,885
Cash paid for income taxes	64,850	-
Non-cash transaction:		
Purchases of property and equipment included in accounts payable	-	57,935
Equipment acquired through capital lease	11,725	-

See accompanying notes.

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2012 and 2011

Note A - Description of Organization

Kentucky Association of Counties, Inc. ("KACo") is a non-profit organization organized under the laws of the Commonwealth of Kentucky. Its membership is the 120 county governments of the state. KACo was formed to improve and enhance county governments and their political subdivisions through educational programs, cooperative undertakings and issue advocacy. The consolidated financial statements include the accounts of KACo and its wholly owned subsidiaries, KACo Insurance Agency, Inc. ("the Agency"), incorporated for the purpose of selling insurance products to county governments in Kentucky, and KACo Financial Advisors, Inc., incorporated in January 2012, for the purpose of providing municipal financial advisory services for counties, schools, special taxing districts, and universities. All inter-company transactions have been eliminated. The consolidated entity is collectively referred to herein as "the Organization".

Note B - Summary of Significant Accounting Policies

1. Basis of Accounting: The consolidated financial statements of the Organization have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The Accounting Standards Codification ("ASC") as produced by the Financial Accounting Standards Board ("FASB") is the sole authoritative GAAP for non-governmental entities. The significant accounting policies are described below to enhance the usefulness of the financial statements to the reader.

Under the ASC, the Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

The Organization reports cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities and changes in net assets as net assets released from restriction.

Permanently restricted net assets include those contributions and other inflows of assets whose use by the Organization is limited by donor-imposed stipulations that neither expire by the passage of time nor can be fulfilled or otherwise removed by the actions of the Organization.

There are no donor-imposed permanent restrictions on the net assets of the Organization.

2. Use of Estimates: The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.
3. Cash and Cash Equivalents: The Organization considers all highly liquid investments, with a maturity of 90 days or less when purchased, not restricted for a particular purpose, to be cash equivalents. The Organization typically maintains with its bank cash and cash equivalents in excess of federally-insured limits.

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note B - Summary of Significant Accounting Policies (Continued)

4. Fair Value Measurements: The ASC has defined fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Organization uses the following fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels in accordance with the ASC. These levels, in order of highest to lowest priority, are described below:

- Level 1 - Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities.
- Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 - Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Organization's own assumptions.

The Organization's fair value measurements are based on quoted prices in active markets for identical assets (Level 1). The Organization believes that the carrying amount reported on the consolidated statements of financial position for money market funds included in cash and cash equivalents approximates fair value.

5. Accounts Receivable: Accounts receivable consists primarily of commissions from insurance policies and membership fees due from different counties that are predetermined amounts based on the size of the county. The Organization provides an allowance for doubtful accounts, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions. Receivables are written-off based on individual credit evaluation and specific circumstances of the client. The Organization's management considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts has been established at June 30, 2012 and 2011.

6. Note Receivable: The note receivable consists of an interest bearing note receivable due from Civic Finance Advisors, LLC, with a principal balance of \$250,000, earning interest of 3% annually, to be repaid by monthly payments of \$4,500, beginning in July 2012. Notes receivable are reported at their outstanding principal, plus any accrued interest. Notes receivable are considered by management to be fully collectible and, accordingly, no allowance for doubtful accounts is considered necessary. In making that determination, management evaluated the financial condition of the borrower and current economic conditions. Past due status is determined based on contractual terms. Interest on the note is recognized over the term of the note and is calculated using the simple-interest method on principal amounts outstanding.

7. Property and Equipment: Property and equipment is recorded at cost, if purchased, or fair market value at date of contribution, if contributed. It is the Organization's policy to capitalize purchases of property and equipment in excess of \$1,500. Lesser amounts are expensed. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets as follows:

Building and improvements	10 - 40 years
Furniture, fixtures and equipment	3 - 10 years
Vehicles	5 years

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note B - Summary of Significant Accounting Policies (Continued)

7. Property and Equipment (Continued): Depreciation expense during the years ended June 30, 2012 and 2011 was \$732,919 and \$757,843, respectively.
8. Assets Held for Sale: Certain properties consisting of the old buildings in which the KACo and affiliates offices were previously located are no longer in use and are held for sale as of June 30, 2012. These assets are shown at the lower of their net book value or fair value less cost to sell.
9. Unearned Revenues: Unearned revenues include amounts received from related parties for the purchase of jointly used office space and equipment and amounts received from related parties for administrative expenses and services of KACo on behalf of the related parties. Unearned amounts for space and equipment are being amortized over the estimated useful lives of the assets, and are recognized as program administration fees within the consolidated statement of activities and changes in net assets. Unearned revenues for program administration fees represent annual fees generated in excess of related expenses and will be recognized as income in the following year. Total deferred amounts from related parties are \$753,303 and \$800,379 at June 30, 2012 and 2011, respectively. The Agency has unearned revenues representing cash received for policies not in effect at year-end of \$48,922 and \$43,269 at June 30, 2012 and 2011, respectively.
10. Advertising Costs: Costs incurred for advertising and promotions are expensed as incurred. Advertising expenses totaled \$113,873 and \$81,229 in 2012 and 2011, respectively.
11. Income Taxes: Kentucky Association of Counties, Inc. is a non-profit corporation under the laws of the Commonwealth of Kentucky and has been granted exemption from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code. KACo Insurance Agency, Inc. and KACo Financial Advisors, Inc. are for-profit corporations subject to income tax.

Deferred income taxes are recorded based upon the temporary differences between the financial statement and tax bases of assets and liabilities and net operating loss carryforwards available for tax purposes.

The Organization recognizes uncertain income tax positions using the "more-likely-than-not" approach as defined in the ASC. No liability for uncertain tax positions has been recorded in the accompanying financial statements. The Organization's 2008-2011 tax years remain open and subject to examination.

12. Reclassifications: Certain amounts in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation.
13. Subsequent Events: Subsequent events for the Organization have been considered through the date of the Independent Auditor's Report, which represents the date which the consolidated financial statements were available to be issued.

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note C - Property and Equipment

Property and equipment as of June 30, 2012 and 2011 consists of:

	<u>2012</u>	<u>2011</u>
Land and improvements	\$ 1,515,315	\$ 1,515,315
Building and improvements	11,580,341	11,596,882
Furniture and fixtures	115,433	114,601
Equipment	1,235,831	1,205,912
Vehicles	<u>216,793</u>	<u>214,582</u>
	14,663,713	14,647,292
Less accumulated depreciation	<u>(2,654,606)</u>	<u>(1,945,695)</u>
	<u>\$ 12,009,107</u>	<u>\$ 12,701,597</u>

Note D - Restricted Cash

Pursuant to the Construction Loan (see Note F), the Organization established a separate bank account to deposit the proceeds. These funds are restricted for the cost of construction of KACo's new building. As of June 30, 2012 and 2011, the balance of the restricted cash is \$0 and \$5,999, respectively.

Note E - Capital Lease Obligations

The Organization is the lessee of office equipment under capital leases expiring in fiscal year 2014 and 2017. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. The assets are amortized over their estimated productive lives. Amortization of assets under capital leases is included in depreciation expense for the years ended June 30, 2012 and 2011. The following table is a summary of office equipment held under capital leases:

Capitalized value of two network copiers under a capital lease obligation payable in monthly installments of \$955, including interest at 5%, through September 2013.	\$ 73,990
Capitalized value of postage machine under a capital lease obligation payable in monthly installments of \$212, including interest at 5%, through October 2016	11,725
Accumulated amortization	<u>(34,016)</u>
	<u>\$ 51,699</u>

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note E - Capital Lease Obligations (Continued)

Minimum future lease payments under capital leases as of June 30, 2012:

Year Ending June 30,	Amount
2013	\$ 25,470
2014	6,365
2015	2,544
2016	2,544
2017	848
	<u>37,771</u>
Less amount representing interest	<u>(1,237)</u>
Present value of net minimum lease payments	36,534
Less current portion	<u>(24,938)</u>
	<u><u>\$ 11,596</u></u>

Interest rates on capitalized leases are imputed based on the lower of the Organization's incremental borrowing rate at the inception of each lease or the lessor's implicit rate of return.

Note F - Related Party Loan

On June 1, 2008, through the County of Christian, Kentucky, the Kentucky Association of Counties Leasing Trust ("COLT"), a related party, issued \$30,000,000 of bonds ("the Bonds"). During 2009, KACo obtained a loan through COLT from the Bond proceeds in the amount of \$12,000,000 for the purpose of financing the construction of a new building to be used by KACo ("Construction Loan"). Principal is payable annually in the amounts as defined in the agreement. KACo pays to COLT monthly interest payments at a fixed rate of 3.35% plus an additional variable rate, if necessary, up to 2.9%. These principal and interest payments ("Loan Payments") are made directly to US Bank on behalf of COLT as a portion of the principal and interest payments owed on the Bonds. KACo is eligible for a discretionary interest rebate from COLT on an annual basis. Average interest rates paid, net of rebates received, for the years ended June 30, 2012 and 2011, were 0.49% and 0.61%, respectively. The balance outstanding on the loan was \$7,910,859 and \$8,932,368 at June 30, 2012 and 2011, respectively.

Substantially all assets of the trust estate, which are owned by COLT and maintained by US Bank, are pledged to secure repayment of the Bonds, which in turn secure the Loan Payments owed by KACo. The Construction Loan matures on January 20, 2028.

As a result of this debt arrangement, KACo is required to maintain certain financial ratios with US Bank. KACo was in compliance with all loan covenants at June 30, 2012 and 2011.

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note F - Related Party Loan (Continued)

Principal payments due on long-term debt for the fiscal years subsequent to June 30, 2012 are as follows:

Fiscal Year Ending June 30,	
2013	\$ 494,840
2014	510,000
2015	525,000
2016	540,000
2017	560,000
Thereafter	5,281,019
	<u>\$ 7,910,859</u>

Note G - Net Assets

Temporarily restricted net assets at June 30, 2012 and 2011 are restricted for future unexpected expenses of the related organizations, also referred to as the program guarantee fund.

Board designated net assets at June 30, 2012 and 2011 represent amounts designated by the Board for the program guarantee fund.

Total net assets set aside for the program guarantee fund are \$1,172,209 and \$922,209 as of June 30, 2012 and 2011, respectively.

Note H - Retirement Plans

The Organization participates in the County Employee Retirement System of the Commonwealth of Kentucky ("CERS"). CERS is a cost-sharing multiple-employer public employee retirement system which covers all eligible full-time employees. Vesting begins after five years upon entry into CERS. CERS also provides death and disability benefits. Benefits are established by state statute. CERS requires employees to contribute 5% of their salary and employers to contribute 18.96% and 16.93% of participants' salaries during the years ended June 30, 2012 and 2011, respectively. The Organization's CERS expenses for the years ended June 30, 2012 and 2011 were \$608,261 and \$538,922, respectively.

The Organization also sponsors a 401(k) defined contribution plan ("the Plan"). The Plan covers substantially all full-time employees. Matching contributions are made to the Plan by the Organization at 100% of the first 6% contributed by participants. The Organization's matching contribution to the Plan was \$164,884 and \$159,618 for the years ended June 30, 2012 and 2011, respectively.

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note I - Related Party Transactions

Insurance and other financial services are provided to KACo members by related organizations governed by separate boards. The transactions and accounts of the related entities are not included in these financial statements. The related entities are as follows:

1. The Kentucky Association of Counties All Lines Fund ("KALF") is a property, casualty and liability self-insurance program organized pursuant to state law and provides insurance, other than workers' compensation, to Kentucky counties and other political subdivisions.
2. The Kentucky Association of Counties Workers' Compensation Fund ("KWC") provides workers' compensation and employers' liability coverage to Kentucky counties and other political subdivisions pursuant to state law.
3. The Kentucky Association of Counties Unemployment Insurance Fund ("KUI") operates as a pooled reimbursing unemployment insurance program that allows Kentucky county governments to meet their statutory obligation to provide unemployment insurance benefits to their employees.
4. The Kentucky Association of Counties Leasing Trust ("COLT") is an inter-local agreement trust that was formed to make funds available for capital improvement projects and equipment purchases by Kentucky county governments and specific districts.
5. The Kentucky Association of Counties Commonwealth Insurance Company ("CIC") was established to provide employee dishonesty fidelity bond coverage to the participant members of KALF.

KACo charges its affiliates a flat program administration fee. This fee covers all expenses which had formerly been directly allocated in an itemized fashion to the affiliates. The program administration fee, which is determined annually, is due ratably to KACo at the beginning of each quarter. Such fees are summarized as follows:

	<u>2012</u>	<u>2011</u>
KACo All Lines Fund	\$ 1,161,481	\$ 1,260,164
KACo Workers' Compensation Fund	1,109,067	1,132,858
KACo Unemployment Insurance Fund	352,899	340,239
KACo Leasing Trust	874,650	862,431
KACo Insurance Agency, Inc.	124,246	77,517
KACo Commonwealth Insurance Company	109,676	54,471
Amount related to joint use of office space and equipment (Note B 9)	<u>127,948</u>	<u>180,338</u>
	3,859,967	3,908,018
Elimination of KACo Insurance Agency, Inc.	<u>(125,199)</u>	<u>(91,357)</u>
	<u><u>\$ 3,734,768</u></u>	<u><u>\$ 3,816,661</u></u>

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note I - Related Party Transactions (Continued)

These separately established entities pay fees to KACo from the fees charged to the programs' participant members which are reflected in the consolidated statement of activities as management fees and license fees. The management fees are summarized as follows:

	<u>2012</u>	<u>2011</u>
KACo All Lines Fund	\$ 934,678	\$ 942,428
KACo Workers' Compensation Fund	973,615	931,013
KACo Unemployment Insurance Fund	256,972	248,350
KACo Leasing Trust	393,360	394,350
KACo Insurance Agency, Inc.	157,920	158,100
KACo Commonwealth Insurance Company	<u>258,289</u>	<u>196,216</u>
	2,974,834	2,870,457
Elimination of KACo Insurance Agency, Inc.	<u>(157,920)</u>	<u>(158,100)</u>
	<u>\$ 2,816,914</u>	<u>\$ 2,712,357</u>

The license fees are summarized as follows:

	<u>2012</u>	<u>2011</u>
KACo All Lines Fund	\$ 1,000	\$ 1,000
KACo Workers' Compensation Fund	1,000	1,000
KACo Unemployment Insurance Fund	1,000	1,000
KACo Leasing Trust	1,000	1,000
KACo Insurance Agency, Inc.	1,000	1,000
KACo Commonwealth Insurance Company	<u>1,000</u>	<u>1,000</u>
	6,000	6,000
Elimination of KACo Insurance Agency, Inc.	<u>(1,000)</u>	<u>(1,000)</u>
	<u>\$ 5,000</u>	<u>\$ 5,000</u>

A summary of all amounts due the Organization by related parties at June 30 is as follows:

	<u>2012</u>	<u>2011</u>
KACo Leasing Trust	\$ 246,381	\$ 291,451

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note I - Related Party Transactions (Continued)

A summary of unearned revenues from the overpayment of license, management and program administrative fees at June 30 is as follows:

	<u>2012</u>	<u>2011</u>
Program Administrative Fee		
KACo All Lines Fund	\$ 270,919	\$ 166,836
KACo Workers' Compensation Fund	219,232	189,442
KACo Unemployment Insurance Fund	28,701	84,962
KACo Leasing Trust	93,650	101,669
KACo Insurance Agency, Inc.	32,354	51,883
KACo Commonwealth Insurance Company	22,924	12,598
Amount related to joint use of office space and equipment	<u>130,649</u>	<u>258,597</u>
	798,429	865,987
Elimination of KACo Insurance Agency, Inc.	<u>(45,126)</u>	<u>(65,608)</u>
	<u><u>\$ 753,303</u></u>	<u><u>\$ 800,379</u></u>

Most of the Organization's insurance is provided by KALF and KWC. During 2012 and 2011, the Organization incurred total insurance expense under these agreements of \$90,185 and \$85,595, respectively.

Note J - KACo Convention

The financial results of the Kentucky Association of Counties annual convention for the years ended June 30, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Convention Income		
Convention registration	\$ 143,976	\$ 135,270
Convention exhibitors	40,755	37,600
Convention sponsors	<u>80,000</u>	<u>64,300</u>
	264,731	237,170
Convention Expenses	<u>242,152</u>	<u>217,544</u>
	<u><u>\$ 22,579</u></u>	<u><u>\$ 19,626</u></u>

Kentucky Association of Counties, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2012 and 2011

Note K - Commitments and Contingencies

The Organization is, from time to time, involved in lawsuits arising in the ordinary course of its business that, in the opinion of management, will not have a material effect on the Organization's financial position, liquidity or results of operations.

Note L - Income Taxes

KACo Insurance Agency, Inc. and KACo Financial Advisors, Inc. recognize deferred tax assets and liabilities for the expected future tax consequence of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse:

The provision for income taxes consists of the following:

	2012			2011
	KACo Insurance Agency, Inc.	KACo Financial Advisors, Inc.	Consolidated	KACo Insurance Agency, Inc.
Current:				
Federal	\$ 32,192	\$ 4,218	\$ 36,410	\$ 49,569
State and local	8,734	655	9,389	7,795
	<u>40,926</u>	<u>4,873</u>	<u>45,799</u>	<u>57,364</u>
Deferred:				
Federal	-	-	-	15,783
State and local	46	-	46	2,353
	<u>46</u>	<u>-</u>	<u>46</u>	<u>18,136</u>
Income Tax Expense	<u>\$ 40,972</u>	<u>\$ 4,873</u>	<u>\$ 45,845</u>	<u>\$ 75,500</u>

Significant components of the Organization's net deferred tax asset consist of the following at year-end:

	2012			2011
	KACo Insurance Agency, Inc.	KACo Financial Advisors, Inc.	Consolidated	KACo Insurance Agency, Inc.
Deferred tax asset				
Charitable contributions	\$ -	\$ -	\$ -	\$ 46
Net operating losses	-	-	-	-
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 46</u>

Supplementary Information

Kentucky Association of Counties, Inc. and Subsidiaries
Consolidated Schedules of Program and Supporting Services
Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Bad debt	\$ -	\$ 100,721
Bank charges	4,431	3,316
Board expense	15,506	7,349
Commissions	48,842	42,485
Communication, promotion and liaison	362,939	270,768
Computer supplies	91,515	85,190
Consulting	1,795	-
Depreciation	732,919	757,843
Endorsement fee	37,893	26,925
Equipment and maintenance	15,756	39,490
Fringe benefits	1,438,133	1,430,791
Grounds and building maintenance	59,772	59,606
Insurance	86,449	83,256
Janitorial service	47,128	44,762
Miscellaneous	26,024	28,215
Office supplies	34,761	28,754
Postage	23,658	19,569
Premiums ceded	95,335	93,792
Printing	22,171	22,391
Professional dues	5,981	5,127
Professional fees	433,190	147,141
Public official bond expense	393,934	368,270
Publications	7,330	7,117
Salaries	3,301,721	3,211,003
Telephone	58,659	55,690
Training session expenses	31,928	28,419
Utilities	66,785	70,531
	<u>\$ 7,444,555</u>	<u>\$ 7,038,521</u>

See independent auditor's report.

Kentucky Association of Counties, Inc. and Subsidiaries
KACo Insurance Agency, Inc. Statement of Cash Flows
Year Ended June 30, 2012

	<u>2012</u>
Cash Flows from Operating Activities	
Changes in net assets	\$ 89,309
Adjustments to reconcile changes in net assets to net cash provided by operating activities:	
Benefit from deferred income taxes	46
Changes in:	
Accounts receivable	21,825
Prepaid expenses	12,986
Accounts payable and accrued liabilities	(23,457)
Unearned revenues	5,653
	<u>106,362</u>
Net Cash Provided by Operating Activities	106,362
Increase in Cash and Cash Equivalents	106,362
Cash and Cash Equivalents at Beginning of Year	<u>491,675</u>
Cash and Cash Equivalents at End of Year	<u><u>\$ 598,037</u></u>
Supplemental Disclosure:	
Cash paid for income taxes	\$ 64,850

See independent auditor's report.

Consolidating Information

Kentucky Association of Counties, Inc. and Subsidiaries
Consolidating Statement of Financial Position
June 30, 2012

	KACo	KACo Insurance Agency, Inc.	KACo Financial Advisors, Inc.	Eliminations	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	\$ 4,843,024	\$ 598,037	\$ 60,531	\$ -	\$ 5,501,592
Accounts receivable	5,904	41,420	-	-	47,324
Due from related parties	246,381	-	-	-	246,381
Assets held for sale	927,140	-	-	-	927,140
Note receivable, current portion	-	-	47,093	-	47,093
Investment in subsidiary	300,000	-	-	(300,000)	-
Prepaid expenses	26,396	52,622	-	(45,126)	33,892
Total Current Assets	6,348,845	692,079	107,624	(345,126)	6,803,422
Property and Equipment, net	12,009,107	-	-	-	12,009,107
Note receivable, net of current portion	-	-	204,782	-	204,782
Total Assets	<u>\$ 18,357,952</u>	<u>\$ 692,079</u>	<u>\$ 312,406</u>	<u>\$ (345,126)</u>	<u>\$ 19,017,311</u>
Liabilities and Net Assets					
Current Liabilities					
Accounts payable and accrued liabilities	\$ 102,341	\$ 42,181	\$ -	\$ -	\$ 144,522
Accrued compensated absences	358,252	-	-	-	358,252
Accrued income taxes	-	-	4,873	-	4,873
Unearned revenues	798,429	48,922	-	(45,126)	802,225
Current portion of capital lease obligations	24,938	-	-	-	24,938
Current portion of related party loan	494,840	-	-	-	494,840
Total Current Liabilities	1,778,800	91,103	4,873	(45,126)	1,829,650
Capital Lease Obligations, net of current portion	11,596	-	-	-	11,596
Related Party Loan, net of current portion	7,416,019	-	-	-	7,416,019
Total Liabilities	9,206,415	91,103	4,873	(45,126)	9,257,265
Commitments and Contingencies					
Net Assets/Equity					
Unrestricted					
Board designated - program guarantee fund	750,000	-	-	-	750,000
Undesignated	7,979,328	-	-	-	7,979,328
Total Unrestricted	8,729,328	-	-	-	8,729,328
Temporarily restricted	422,209	-	-	-	422,209
Common stock, no par	-	-	300,000	(300,000)	-
Retained earnings	-	600,976	7,533	-	608,509
Total Net Assets/Equity	9,151,537	600,976	307,533	(300,000)	9,760,046
Total Liabilities and Net Assets	<u>\$ 18,357,952</u>	<u>\$ 692,079</u>	<u>\$ 312,406</u>	<u>\$ (345,126)</u>	<u>\$ 19,017,311</u>

See independent auditor's report.

Kentucky Association of Counties, Inc. and Subsidiaries
Consolidating Statement of Unrestricted Activities
Year Ended June 30, 2012

	KACo	KACo Insurance Agency, Inc.	KACo Financial Advisors, Inc.	Eliminations	Consolidated
Changes in unrestricted net assets					
Revenues, gains and other support					
Program administration fees	\$ 3,859,967	\$ -	\$ -	\$ (125,199)	\$ 3,734,768
Management fees	2,974,834	-	-	(157,920)	2,816,914
Advisory fees	-	-	296,712	-	296,712
License fees	6,000	-	-	(1,000)	5,000
Public official bond revenue	-	403,986	-	-	403,986
Commissions - other	-	619,401	-	-	619,401
Membership dues	185,450	-	-	-	185,450
Training session fees	54,215	-	-	-	54,215
Interest income	47,045	1,577	1,911	-	50,533
Rental income	47,250	-	-	-	47,250
Endorsement and marketing fees	38,285	-	-	-	38,285
KACo convention, net	22,579	-	-	-	22,579
Gain on disposal of fixed assets	7,400	-	-	-	7,400
Miscellaneous	4,369	-	-	-	4,369
	<u>7,247,394</u>	<u>1,024,964</u>	<u>298,623</u>	<u>(284,119)</u>	<u>8,286,862</u>
Expenses					
Program services	4,910,830	576,004	267,246	-	5,754,080
Supporting services	1,636,944	318,679	18,971	(284,119)	1,690,475
Interest expense	42,165	-	-	-	42,165
Provision for income taxes	-	40,972	4,873	-	45,845
	<u>6,589,939</u>	<u>935,655</u>	<u>291,090</u>	<u>(284,119)</u>	<u>7,532,565</u>
Increase in Unrestricted Net Assets	<u>\$ 657,455</u>	<u>\$ 89,309</u>	<u>\$ 7,533</u>	<u>\$ -</u>	<u>\$ 754,297</u>

See independent auditor's report.

Kentucky Association of Counties, Inc. and Subsidiaries
Consolidating Schedule of Program and Supporting Services
Year Ended June 30, 2012

	KACo	KACo Insurance Agency, Inc.	KACo Financial Advisors, Inc.	Eliminations	Consolidated
Bank charges	\$ 4,431	\$ -	\$ -	\$ -	\$ 4,431
Board expense	-	8,749	6,757	-	15,506
Commissions	-	48,842	-	-	48,842
Communication, promotion and liaison	352,836	10,103	-	-	362,939
Computer supplies	91,515	-	-	-	91,515
Consulting	-	-	1,795	-	1,795
Depreciation	732,919	-	-	-	732,919
Endorsement fee	-	37,893	-	-	37,893
Equipment and maintenance	15,756	-	-	-	15,756
Fringe benefits	1,438,133	-	-	-	1,438,133
Grounds and building maintenance	59,772	-	-	-	59,772
Insurance	74,493	11,956	-	-	86,449
Janitorial service	47,128	-	-	-	47,128
Miscellaneous	25,417	597	10	-	26,024
Office supplies	34,761	-	-	-	34,761
Postage	23,658	-	-	-	23,658
Premiums ceded	-	95,335	-	-	95,335
Printing	22,171	-	-	-	22,171
Professional dues	5,981	-	-	-	5,981
Professional fees	152,380	3,155	277,655	-	433,190
Program administration, management and license fees	-	284,119	-	(284,119)	-
Public official bond expense	-	393,934	-	-	393,934
Publications	7,330	-	-	-	7,330
Salaries	3,301,721	-	-	-	3,301,721
Telephone	58,659	-	-	-	58,659
Training session expenses	31,928	-	-	-	31,928
Utilities	66,785	-	-	-	66,785
	<u>\$ 6,547,774</u>	<u>\$ 894,683</u>	<u>\$ 286,217</u>	<u>\$ (284,119)</u>	<u>\$ 7,444,555</u>

See independent auditor's report.