KENTUCKY ASSOCIATION OF COUNTIES UNEMPLOYMENT COMPENSATION SELF-INSURANCE FUND

FINANCIAL STATEMENTS

Years Ended June 30, 2013 and 2012

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DMLO
DEMING MALONE
LIVESAY & OSTROFF
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' Report

To the Board of Trustees
Kentucky Association of Counties Unemployment
Compensation Self-Insurance Fund
Frankfort, Kentucky

We have audited the accompanying financial statements of Kentucky Association of Counties Unemployment Compensation Self-Insurance Fund as of June 30, 2013 and 2012, and the related statements of revenues, expenses and changes in members' equity 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.

Auditors' 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. Those standards require that we plan and perform the audits 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 auditors' 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.

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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 financial position of Kentucky Association of Counties Unemployment Compensation Self-Insurance Fund as of June 30, 2013 and 2012, and the 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
February 12, 2014

KENTUCKY ASSOCIATION OF COUNTIES
UNEMPLOYMENT COMPENSATION SELF-INSURANCE FUND

BALANCE SHEETS
June 30, 2013 and 2012

Assets	2013	2012
Cash and cash equivalents	$ 4,561,868	$ 4,776,968
Investments, at fair market value	2,566,837	2,303,502
Premiums receivable, less allowance for doubtful accounts of $0 in 2013 and $15,000 in 2012	1,813,176	842,939
Accrued interest receivable	3,586	7,391
Prepaid expenses	34,020	32,475
Total assets	$ 8,979,487	$ 7,963,275
Liabilities and Members' Equity		
Unemployment compensation claims payable	$ 550,233	$ 592,233
Deferred revenue	1,992,573	1,524,279
Total liabilities	2,542,806	2,116,512
Members' equity	6,436,681	5,846,763
Total liabilities and members' equity	$ 8,979,487	$ 7,963,275

See Notes to Financial Statements.

KENTUCKY ASSOCIATION OF COUNTIES
UNEMPLOYMENT COMPENSATION SELF-INSURANCE FUND

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN MEMBERS' EQUITY
Years Ended June 30, 2013 and 2012

	2013	2012
Revenues		
Member premiums, net	$ 3,519,701	$ 2,810,421
Investment income	69,259	146,431
Realized loss on sale of investments	(25,758)	(78,784)
Unrealized (loss) gain on investments	(86,052)	63,644
Total revenues	3,477,150	2,941,712
Expenses		
Unemployment compensation benefits	2,190,142	3,463,431
General and administrative expenses	426,090	427,646
KACO management fee	270,000	256,972
KACO royalty	1,000	1,000
Total expenses	2,887,232	4,149,049
Excess of revenues (expenses)	589,918	(1,207,337)
Members' equity, beginning of year	5,846,763	7,054,100
Members' equity, end of year	$ 6,436,681	$ 5,846,763

See Notes to Financial Statements.

KENTUCKY ASSOCIATION OF COUNTIES
UNEMPLOYMENT COMPENSATION SELF-INSURANCE FUND

STATEMENTS OF CASH FLOWS
Years Ended June 30, 2013 and 2012

	2013	2012
Cash Flows from Operating Activities		
Cash received from member premiums	$ 3,032,758	$ 3,663,768
Investment income received	73,064	151,769
Unemployment compensation benefits paid	(2,232,142)	(3,998,901)
Cash paid to suppliers and others	(713,635)	(631,531)
Net cash provided by (used in) operating activities	160,045	(814,895)
Cash Flows from Investing Activities		
Purchase of investments	(1,544,794)	(1,167,352)
Proceeds from sale and maturities of investments	1,169,649	4,262,067
Net cash (used in) provided by investing activities	(375,145)	3,094,715
Net (decrease) increase in cash and cash equivalents	(215,100)	2,279,820
Cash and cash equivalents at beginning of year	4,776,968	2,497,148
Cash and cash equivalents at end of year	$ 4,561,868	$ 4,776,968

See Notes to Financial Statements.

	2013	2012
Reconciliation of Excess of Revenue (Expenses) to Net Cash Provided by (Used in) Operating Activities		
Excess of revenues (expenses)	$ 589,918	$ (1,207,337)
Adjustments to reconcile excess of revenues (expenses) to net cash provided by (used in) operating activities:		
Realized loss on sale of investments	25,758	78,784
Unrealized loss (gain) on investments	86,052	(63,644)
Change in allowance for doubtful accounts	(15,000)	
Changes in assets and liabilities:		
Decrease (increase) in:		
Premiums receivable	(955,237)	610,644
Accrued interest receivable	3,805	5,338
Prepaid expenses	(1,545)	56,261
Increase (decrease) in:		
Accounts payable		(2,174)
Unemployment compensation claims payable	(42,000)	(535,470)
Deferred revenue	468,294	242,703
Total adjustments	(429,873)	392,442
Net cash provided by (used in) operating activities	$ 160,045	$ (814,895)

KENTUCKY ASSOCIATION OF COUNTIES
UNEMPLOYMENT COMPENSATION SELF-INSURANCE FUND

NOTES TO FINANCIAL STATEMENTS

Note 1. Description of Fund and Summary of Significant Accounting Policies

The Kentucky Association of Counties Unemployment Compensation Self-Insurance Fund (Fund) was formed by the Kentucky Association of Counties (KACO) to receive contributions from eligible members to be used to reimburse the Commonwealth of Kentucky for unemployment compensation benefits paid to eligible members' employees. Governmental entities located in Kentucky who are members of KACO are eligible to make annual contributions to the Fund as determined by the Trustees in lieu of making contributions to the Kentucky Unemployment Compensation Fund. Each member is jointly and severally liable for reimbursing the Commonwealth in an amount equal to the quarterly benefits paid that are attributable to services performed in the employ of any or all members of the Fund.

Summary of significant accounting policies:

This summary of significant accounting policies of the Kentucky Association of Counties Unemployment Compensation Self-Insurance Fund is presented to assist in the understanding of the Fund's financial statements. The financial statements and notes 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.

Investments and credit risk:

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

The Fund has significant investments in mutual funds and mortgage-backed securities held by Central Bank & Trust Company. 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.

Premiums receivable:

Premiums receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense and an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to premiums receivable. Amounts are past due when not paid by the discount date.

Revenue recognition:

Member premiums revenue is recognized over the period to which the premiums relate. Premiums billed but not yet earned as of June 30, 2013 and 2012 are recorded as deferred revenue on the balance sheet.

Unemployment compensation claims payable:

The liability payable to the Commonwealth of Kentucky represents the actual benefits paid by the Commonwealth for the quarter ended June 30, 2013 and 2012.

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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents:

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

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.

As of June 30, 2013 and 2012, 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 ending on or after June 30, 2010 remain subject to IRS review and change.

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, plus a geographic risk, by writing all of its business in Kentucky, thus increasing its exposure to a single jurisdiction.

Subsequent events:

Management has evaluated subsequent events through February 12, 2014, the date which 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 by Central Bank & Trust Company and FSC Securities Corporation at June 30, 2013 and 2012 consisted of the following:

	June 30, 2013		
	Face Value	Cost	Fair Market Value
Mortgage-backed securities:			
Federal Home Loan Bank	$1,598,800	$1,598,800	$1,546,432
Federal Farm Credit Bank	793,600	793,600	769,072
Federal National Mortgage	252,393	252,393	251,333
Total investments	$2,644,793	$2,644,793	$2,566,837

	June 30, 2012		
	Face Value	Cost	Fair Market Value
Eaton Vance Mutual Fund		$1,195,406	$1,198,728
Mortgage-backed securities:			
Federal Home Loan Bank	$1,100,000	1,100,000	1,104,774
Total investments	$1,100,000	$2,295,406	$2,303,502

The aggregate fair market value of annual maturities of investments at June 30, 2013 and 2012, based upon stated maturity dates are as follows:

	2013	2012
Due after five to ten years	$2,566,837	$1,104,774
Eaton Vance Mutual Fund		1,198,728
	$2,566,837	$2,303,502

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, 2013.

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

Mortgage-backed securities – valued using quoted market prices for similar assets.

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.

NOTES TO FINANCIAL STATEMENTS

The following table sets forth, by level, within the fair value hierarchy, the Fund's assets at fair value as of June 30, 2013 and 2012:

	2013		
	Level 1	Level 2	Total
Mortgage-backed securities		$2,566,837	$2,566,837
Total assets at fair value		$2,566,837	$2,566,837

	2012		
	Level 1	Level 2	Total
Mutual funds	$1,198,728		$1,198,728
Mortgage-backed securities		$1,104,774	1,104,774
Total assets at fair value	$1,198,728	$1,104,774	$2,303,502

Note 4. Members' Equity

Members' equity consists of separate accounts maintained for each member. Each member's equity balance is increased by its contributions and allocated share of investment and other revenues, and decreased by unemployment compensation benefits paid on its behalf, dividends distributed and the allocated share of other expenses. At June 30, 2013 and 2012, members' equity consists of:

	2013	2012
Members with equity	$ 8,523,829	$ 8,454,313
Members with a deficit	(2,087,148)	(2,607,550)
Total members' equity	$ 6,436,681	$ 5,846,763

Note 5. Related Party Transactions

The Fund has a Program Administration Agreement whereby the Fund paid a set fee of $106,650 and $95,400 per quarter for 2013 and 2012, respectively, to KACO to provide management and administrative services for the Fund. The total fee is adjusted annually based upon the actual allocation of expenses covered by the agreement. For the years ended June 30, 2013 and 2012, actual expenses allocated to the Fund were $34,020 and $28,701less than the program administration fee, respectively. This amount will be utilized to reduce the Fund's future payment to KACO and is included in prepaid expenses on the June 30, 2013 and 2012 balance sheets. An additional management fee of $270,000 and $256,970 was paid to KACO for the years ended June 30, 2013 and 2012, respectively.

The Fund has a licensing agreement with KACO that requires the Fund to pay an annual royalty to KACO in return for the use of KACO's name and logo. The Fund paid royalties of $1,000 for each of the years ended June 30, 2013 and 2012.

Note 6. 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, 2013, the uninsured cash balances totaled approximately $4,000,000.