COMMONWEALTH INSURANCE COMPANY, INC.

FINANCIAL STATEMENTS

Years Ended June 30, 2015 and 2014

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DMLO
DEMING MALONE
LIVESAY & OSTROFF
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' Report

To the Stockholder
Commonwealth Insurance Company, Inc.
Frankfort, Kentucky

We have audited the accompanying financial statements of Commonwealth Insurance Company, Inc. (a Kentucky corporation), which comprise the balance sheets as of June 30, 2015 and 2014, and the related statements of income and comprehensive income, stockholder's 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 financial statement presentation.

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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 Commonwealth Insurance Company, Inc. as of June 30, 2015 and 2014 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deming, Malone, Livesay & Ostroff

Louisville, Kentucky
October 22, 2015

COMMONWEALTH INSURANCE COMPANY, INC.

BALANCE SHEETS
June 30, 2015 and 2014

Assets	2015	2014
Cash and cash equivalents	$ 684,176	$ 1,558,394
Investments, at fair market value	5,293,748	4,044,119
Other	87,919	55,531
Total assets	$ 6,065,843	$ 5,658,044
Liabilities and Stockholder's Equity		
Estimated liability for future claims, net of estimated recoveries:		
Reported claims	$ 143,000	$ 64,000
Claims incurred but not reported	432,000	371,000
	575,000	435,000
Accounts payable and accrued expenses		8,742
Total liabilities	575,000	443,742
Stockholder's Equity		
Common stock, no par value; authorized 1,000 shares; issued and outstanding, 600 shares	1,500,000	1,500,000
Retained earnings	3,957,969	3,699,960
Accumulated other comprehensive income	32,874	14,342
	5,490,843	5,214,302
Total liabilities and stockholder's equity	$ 6,065,843	$ 5,658,044

See Notes to Financial Statements.

COMMONWEALTH INSURANCE COMPANY, INC.

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

Years Ended June 30, 2015 and 2014

	2015	2014
Revenues		
Premium revenue	$ 950,000	$ 850,000
Investment income	132,882	88,164
Realized gains on investments	38,945	179,408
Total revenues	1,121,827	1,117,572
Expenses		
Claims expense and change in estimated liability for future claims	400,294	145,000
Management and marketing	128,178	116,213
Professional fees	31,609	16,218
Management fee	248,200	245,200
Provision for income taxes	55,537	82,985
Total expenses	863,818	605,616
Net income	258,009	511,956
Other Comprehensive Income (Loss)		
Unrealized gain on investments	57,477	62,836
Reclassification adjustment	(38,945)	(18,785)
	18,532	44,051
Total comprehensive income	$ 276,541	$ 556,007

See Notes to Financial Statements.

COMMONWEALTH INSURANCE COMPANY, INC.

STATEMENTS OF STOCKHOLDER'S EQUITY
Years Ended June 30, 2015 and 2014

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balances, June 30, 2013	$ 1,500,000	$ 3,188,004	$ (29,709)	$ 4,658,295
Net income		511,956		511,956
Other comprehensive income			44,051	44,051
Balances, June 30, 2014	1,500,000	3,699,960	14,342	5,214,302
Net income		258,009		258,009
Other comprehensive income			18,532	18,532
Balances, June 30, 2015	$ 1,500,000	$ 3,957,969	$ 32,874	$ 5,490,843

See Notes to Financial Statements.

COMMONWEALTH INSURANCE COMPANY, INC.

STATEMENTS OF CASH FLOWS
Years Ended June 30, 2015 and 2014

	2015	2014
Cash Flows from Operating Activities		
Cash received from premiums	$ 950,000	$ 850,000
Cash paid to suppliers	(391,159)	(364,177)
Claims paid	(260,294)	
Investment income received	128,073	80,156
Income taxes paid	(108,686)	(72,015)
Net cash provided by operating activities	317,934	493,964
Cash Flows from Investing Activities		
Purchase of investments	(3,248,266)	(2,735,543)
Proceeds from sale of investments	2,056,114	1,861,971
Net cash used in investing activities	(1,192,152)	(873,572)
Net decrease in cash and cash equivalents	(874,218)	(379,608)
Cash and cash equivalents at beginning of year	1,558,394	1,938,002
Cash and cash equivalents at end of year	$ 684,176	$ 1,558,394
Reconciliation of Net Income to Net Cash Provided by Operating Activities		
Net income	$ 258,009	$ 511,956
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized gains on investments	(38,945)	(179,408)
Changes in assets and liabilities:		
Decrease (increase) in:		
Other	(32,388)	12,674
Increase (decrease) in:		
Estimated liability for future claims	140,000	145,000
Accounts payable and accrued expenses	(8,742)	3,742
Total adjustments	59,925	(17,992)
Net cash provided by operating activities	$ 317,934	$ 493,964

See Notes to Financial Statements.

COMMONWEALTH INSURANCE COMPANY, INC.

NOTES TO FINANCIAL STATEMENTS

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

Nature of business:

Commonwealth Insurance Company, Inc., a wholly owned subsidiary of Kentucky Association of Counties Leasing Trust (COLT), provides employee dishonesty fidelity bond, property and income/extra expense coverage to the members of the Kentucky Association of Counties - All Lines Fund (KALF), a related party (see Note 5).

Summary of significant accounting policies:

This summary of significant accounting policies of Commonwealth Insurance Company, Inc. is presented to assist in understanding the Company's financial statements. The financial statements are representations of the Company'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.

Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual events and results could differ from those assumptions and estimates.

A significant estimate in these financial statements is the estimated liability for claims incurred but not reported (see Note 4).

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 Company 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 Company does business. The Company mitigates this risk by adhering to specified underwriting practices.

Investments:

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

The Company had significant investments in government 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. The Company considers all investments to be classified as available-for-sale. Basis is determined on historical purchase price.

Cash and cash equivalents:

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

Revenue and expense recognition:

Premium revenue is recognized over the period to which the insurance coverage relates.

Expenses for management and marketing fees and royalties are expensed ratably over the period of coverage.

Subsequent events:

Subsequent events have been evaluated through October 22, 2015, 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 at June 30, 2015 consisted of the following:

	2015				
	Face Value	Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Market Value
U.S. Governmental agency and Mortgage-Backed Securities:					
FNMA	$ 445,000	$ 447,719	$ (3,981)		$ 443,738
FHLB	400,000	407,081	(2,868)		404,213
FHLMC	150,000	149,970	(5,174)		144,796
FFCB	350,000	350,000	(4,406)	$ 87	345,681
FGPC	213,790	223,765		1,485	225,250
U.S Treasury note	350,000	351,390	(786)	129	350,733
FNMS	544,110	545,492		11,649	557,141
	$2,452,900	2,475,417	(17,215)	13,350	2,471,552
Corporate bonds		1,188,342	(8,856)	9,798	1,189,284
Common stocks		1,343,011	(43,322)	83,957	1,383,646
Municipal bonds		254,104	(4,838)		249,266
Total investments		$5,260,874	$(74,231)	$107,105	$5,293,748

NOTES TO FINANCIAL STATEMENTS

Investments held in trust funds by Central Bank & Trust Company at June 30, 2014 consisted of the following:

	2014				
	Face Value	Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Market Value
U.S. Governmental agency and Mortgage-Backed Securities:					
FNMA	$ 200,000	$ 200,000	$ (1,938)		$ 198,062
FHLB	150,000	150,000	(5,402)		144,598
FHLMC	525,000	526,701	(7,720)		518,981
FFCB	350,000	350,000	(7,650)	$ 64	342,414
FGPC	269,220	282,215		2,064	284,279
FNMS	592,396	594,048		9,907	603,955
	$2,086,616	2,102,964	(22,710)	12,035	2,092,289
Corporate bonds		1,207,272	(2,880)	10,763	1,215,155
Common stocks		465,437	(3,410)	27,264	489,291
Municipal bonds		254,104	(6,720)		247,384
Total investments		$4,029,777	$(35,720)	$ 50,062	$4,044,119

The aggregate annual maturities of the fair market value of investments at June 30, 2015, based upon stated maturity dates are as follows:

Due within one year	$ 482,026
Due after one year through five years	1,773,576
Due after five years through ten years	657,074
Due after ten years	997,426
Common stocks	1,383,646
	$5,293,748

NOTES TO FINANCIAL STATEMENTS

The following table summarizes securities with unrealized losses at June 30, 2015 and 2014, aggregated by major security type and length of time in a continuous unrealized loss position:

	2015					
	Less than 12 Months		12 Months or More		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
U.S. Governmental agency and Mortgage-Backed Securities:						
FNMA	$ (3,268)	$ 394,451	$ (713)	$ 49,287	$ (3,981)	$ 443,738
FHLB	(331)	306,750	(2,537)	97,463	(2,868)	404,213
FHLMC			(5,174)	144,796	(5,174)	144,796
FFCB			(4,406)	195,594	(4,406)	195,594
US Treasury note	(786)	300,702			(786)	300,702
Corporate bonds	(2,764)	190,085	(6,092)	311,329	(8,856)	501,414
Common stocks	(36,132)	475,095	(7,190)	140,785	(43,322)	615,880
Municipal bonds			(4,838)	249,266	(4,838)	249,266
Total investments	$(43,281)	$1,667,083	$(30,950)	$1,188,520	$(74,231)	$2,855,603

	2014					
	Less than 12 Months		12 Months or More		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
U.S. Governmental agency and Mortgage-Backed Securities:						
FNMA			$ (1,938)	$198,062	$ (1,938)	$198,062
FHLB			(5,402)	144,598	(5,402)	144,598
FHLMC	$ (752)	$375,979	(6,968)	143,002	(7,720)	518,981
FFCB			(7,650)	192,351	(7,650)	192,351
Corporate bonds	(530)	110,417	(2,350)	204,124	(2,880)	314,541
Common stocks	(3,410)	122,111			(3,410)	122,111
Municipal bonds			(6,720)	247,384	(6,720)	247,384
Total investments	$ (4,692)	$608,507	$(31,028)	$1,129,521	$(35,720)	$ 1,738,028

Investments in an unrealized loss position at June 30, 2015 and 2014 were temporarily impaired due to the current interest rate and market environment and not increased credit risk. In estimating other-than-temporary impairment losses, the Company considers, among other things, the length of time and the extent to which the fair value has been less than cost, and the financial condition and near-term prospects of the issuer. The Company does not intend to sell these securities, and it is more likely than not that the Company will not be required to sell before a period of time sufficient to allow for any anticipated recovery in cost.

Note 3. Fair Value Measurements

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). 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 Company 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. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

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 maximize the use of observable inputs and minimize the use of unobservable inputs.

NOTES TO FINANCIAL STATEMENTS

All assets have been valued using a market approach. 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, 2015 and 2014.

Common stocks – valued at the unadjusted quoted market price as of the financial statement date.

Corporate bonds, municipal bonds, U.S. governmental agency and mortgage-backed securities – valued at the 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 Company 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, 2015:

	Level 1	Level 2	Total
U.S. Governmental and			
Mortgage-backed securities		$2,471,552	$2,471,552
Corporate bonds		1,189,284	1,189,284
Municipal bonds		249,266	249,266
Common stocks			
Technology	$ 415,573		415,573
Financial	57,262		57,262
Basic materials	198,361		198,361
Services	58,252		58,252
Industrial goods	196,073		196,073
Healthcare	114,836		114,836
Consumer goods	343,289		343,289
Total assets at fair value	$1,383,346	$3,910,102	$5,293,748

The following table sets forth, by level, within the fair value hierarchy, the Fund's assets at fair value as of June 30, 2014:

	Level 1	Level 2	Total
U.S. Governmental and			
Mortgage-backed securities		$2,092,289	$2,092,289
Corporate bonds		1,215,155	1,215,155
Municipal bonds		247,384	247,384
Common stocks			
Technology	$ 84,862		84,862
Financial	10,288		10,288
Basic materials	52,252		52,252
Services	72,473		72,473
Industrial goods	70,848		70,848
Healthcare	74,026		74,026
Consumer goods	124,542		124,542
Total assets at fair value	$489,291	$3,554,828	$4,044,119

Note 4. Estimated Unpaid Claims Liabilities

Under Kentucky Law, the Company is required to pay all valid claims against its policyholder. The Company covers losses for employee dishonesty coverage up to a maximum of $140,000 per event after deductibles. The Company covers losses for business income coverage up to a maximum of $125,000 per event after deductibles. The estimated liability for future claims, net of estimated recoveries for deductibles and subrogation was determined by Company management as a result of consultation with the Company's actuary, By The Numbers Actuarial Consulting, Inc., for the years ended June 30, 2015 and 2014.

The actuary provides 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 income reflects adjustments in the year they occur.

NOTES TO FINANCIAL STATEMENTS

For the years ended June 30, 2015 and 2014, the actuary provided a possible range of discounted estimated liabilities. The discounted liability selected by management was discounted at 2.0%, based upon an estimate of the Company's yield on its investments and expected claims payment patterns as developed by the actuary. The loss payment pattern used could vary significantly from actual which would have a direct effect on the liability for estimated claims. The range of discounted liabilities and the amounts selected by management are as follows:

	Low	High	Selected
June 30, 2015	$320,000	$670,000	$575,000
June 30, 2014	$240,000	$510,000	$435,000

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, 2015 and 2014:

	2015	2014
Unpaid claims and claim adjustment expenses at beginning of year	$ 435,000	$ 290,000
Incurred claims and claim adjustment expenses:		
Provision for insured events of current year and changes in provision for insured events of prior years net of recoveries	400,294	145,000
Payments:		
Claims and claims adjustment expenses paid attributable to insured events of current and prior years net of recoveries collected.	(260,294)	
Unpaid claims and claim adjustment expenses at end of year	$ 575,000	$ 435,000

Note 5. Related Party Transactions

For the years ended June 30, 2015 and 2014, 100% of the Company's premium revenue was derived from Kentucky Association of Counties - All Lines Fund, which provides coverage to its members.

The Company is under a Program Administration Agreement with KACo in which the Company reimburses KACo for certain administrative expenses. Total fees for the years ended June 30, 2015 and 2014 under this agreement were $74,416 and $71,605, respectively. As of June 30, 2015 and 2014, the Company had prepaid administrative fees of $21,598 and $38,359, respectively.

The Company is under a Management Fee Agreement with KACo in which the Company pays a fee to KACo for certain management services. The management fees for the years ended June 30, 2015 and 2014 include a base fee of $219,700 plus 3% of earned premiums collected. Total management fees for the years ended June 30, 2015 and 2014 were $248,200 and $245,200, respectively.

The Company also has a licensing agreement with KACo that requires the Company to pay a royalty to KACo in return for the use of KACo's name and logo. The royalty for each of the years ended June 30, 2015 and 2014 was $1,000.

The Company has an agreement with KACo Insurance Agency, Inc. (KIA), whereby KIA acts as the exclusive agent for the Company. The Company paid commissions to KIA of $23,750 and $21,250, for the years ended June 30, 2015 and 2014, respectively.

Note 6. Income Taxes

For federal income tax purposes, the Company is classified as an insurance company, other than a life insurance company, as described under Internal Revenue Code Section 831. The Company also qualifies under Code Section 834 for an alternative income tax calculation available to certain electing small insurance companies which have net premium income not exceeding $1,200,000. Under this election, the Company is taxed only on its net investment income. The Company is exempt from Kentucky corporate income taxes but is subject to a tax on its earned premiums collected as a captive insurer. Total federal and Kentucky tax expense for the years ended June 30, 2015 and 2014 were $55,536 and $82,985, respectively.

As of June 30, 2015 and 2014, the Company 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.

Note 7. Concentration of Credit Risk

The Company's cash accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. At June 30, 2015, the Company's uninsured cash balance was approximately $252,000.