Kentucky School Boards Insurance Trust
Property and Liability Fund

Financial Statements

Years Ended June 30, 2011 and 2010

Kentucky School Boards Insurance Trust Property and Liability Fund

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June 30, 2011 and 2010

Mountjoy
Chilton
Medley

Independent Auditor's Report on Financial Statements

To the Board of Trustees
Kentucky School Boards Insurance Trust
Property and Liability Fund

We have audited the accompanying statements of net deficit of Kentucky School Boards Insurance Trust Property and Liability Fund (Fund) as of June 30, 2011 and 2010 and the related statements of revenues, expenses and changes in net deficit, 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 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 Fund'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 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.

As discussed in NOTE H, the Fund has included in net deficit, a surplus note issued to the Kentucky League of Cities Insurance Service Association. Such inclusion in net deficit is allowed under the insurance laws of the Commonwealth of Kentucky but is not in accordance with accounting principles generally accepted in the United States.

In our opinion, except for the effects of the inclusion in net deficit, a surplus note as described in the preceding paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Kentucky School Boards Insurance Trust Property and Liability Fund as of June 30, 2011 and 2010 and the changes in its net deficit and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis on pages 3 - 5 and the claims development information included on pages 22 - 23 are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. These sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

175 East Main Street
Suite 200
Lexington, KY 40507

859.514.7800 Phone
859.514.7805 Fax
www.mcmcpa.com

Louisville
Lexington
Covington
Frankfort

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on pages 18 – 21 is presented for the purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 basic financial statements taken as a whole.

Mountjoy Chilton Medley LLP

Lexington, Kentucky
October 26, 2011

Kentucky School Boards Insurance Trust
Property and Liability Fund

Management Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky School Boards Insurance Trust Property and Liability Fund (Fund) provides an overview of the Fund's financial activity for the fiscal year ended June 30, 2011. It should be read in conjunction with the financial statements, which begin on page 6.

Using This Annual Report

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

Statements of Net Deficit

The Kentucky League of Cities, Inc. (KLC) began administering the Kentucky School Boards Insurance Trust (KSBIT) program on January 1, 2010, the middle of the July 2009 through June 2010 policy period. This resulted in the immediate transfer of responsibility for claims handling and loss control administration to KLC. The first underwriting and marketing responsibility for KLC relating to the KSBIT program begins with the July 2010 through June 2011 policy year. The Trust and the Kentucky League of Cities Insurance Services Association (KLCIS) agreed on a plan under which KLCIS will help the Trust meet statutory surplus requirements for the Property and Liability Fund and Workers' Compensation Fund and KLC will administer the Funds. In this agreement, KLCIS agreed to purchase from the Trust two surplus notes in the amount of $2,500,000 for the Property and Liability Fund and $5,500,000 for the Workers' Compensation Fund (see Note H). The proceeds of the surplus notes were applied by the Trust for the purpose of reducing the existing deficit in the Funds. In the agreement, the Kentucky School Boards Association (KSBA) agreed to endorse exclusively the Property and Liability Fund and Workers' Compensation Fund and to provide certain services to the Funds for a fee.

Table 1 shows all the assets and liabilities of the Fund and is presented on the accrual basis. Total net deficit increased $603,562 for the current fiscal year. The primary reasons for the current year's loss center on a couple of unusually severe and isolated claim instances that occurred right before year-end.

Table 1
Net Assets

	June 30, 2011	June 30, 2010
Cash and investments	$ 10,057,388	$ 9,609,025
Capital and other assets	3,074,321	2,612,551
Total assets	13,131,709	12,221,576
Unpaid losses and loss adjustment expenses	11,737,045	11,010,220
Other liabilities	2,132,524	1,345,654
Total liabilities	13,869,569	12,355,874
Total net deficit	$ (737,860)	$ (134,298)

Statements of Revenues, Expenses and Changes in Net Deficit

Table 2 shows the revenue and expenses of the Fund and is also presented on the accrual basis. Net earned premium revenue has increased by $1,373,552 or 19.7% from the prior fiscal year. General administrative expenses increased $453,331 or 18.4% from the prior year. A change in claims administrators on January 1, 2010 continues to play a significant role in determining loss and loss adjustment expenses. Loss and loss adjustment expenses decreased $263,112 or 4.1% from the prior year. Upon the transfer of claims files from the prior claims administrator an immediate emphasis was placed upon a reevaluation of existing reserves and claim closures which resulted in an apparent strengthening of reserves and a considerable reduction in open claims count. The resulting change in historical payment patterns and reserving levels continues to be a variable for the actuary to consider, when evaluating the ultimate impact of these changes. The Fund has been able to save considerable cost by paying one price to manage claims, as opposed to allocating these costs to individual claims files.

Table 2
Changes in Net Deficit

	Year Ended	
	June 30, 2011	June 30, 2010
Net premiums earned	$ 8,348,241	$ 6,974,689
Investment and other revenue and gains, net	169,117	254,780
Total revenues	8,517,358	7,229,469
Losses and loss adjustment expenses	6,198,108	6,461,220
General administrative expenses	2,922,812	2,469,481
Total expenses	9,120,920	8,930,701
Total change in net deficit	$ (603,562)	$ (1,701,232)

Description of Current Expected Conditions

In the upcoming year, the Fund expects considerable improvement from the prior year results. The basis for this expectation comes as a result of several factors including the following:

- Efficiency gains and economies of scale – The ability to combine resources, build upon existing relationships and benefit from the increased purchasing power in the reinsurance market provides real opportunities for potential and expected cost savings.
- Investments – An independent investment consultant was engaged by the Board of Directors to work with existing investment advisors on improving investment policies and strategies to maximize overall investment results.
- Claims administration – Standardizing legal rates and decreasing attorney travel time continues to produce lower levels of allocated loss adjustment expenses on individual claim files, thus showing a much lower legal-to-total claim cost ratio than historically reported.
- Loss control – More loss control professionals continue to actively provide risk management services to the Fund's members, spending extra time with the members with significant loss experience.
- Fee reductions – To assist with the expense load, several parties agreed to reduce fees for the good of the program going forward into the 2012 year. The reduction in fees from local agents and KSBA total approximately $600,000 for Liability, Property and Workers' Compensation.

Contacting the Organization's Financial Management

This financial report is designed to provide a general overview of 2011's finances and to show the Fund's accountability to its members. If you have any questions about this report or need additional information, contact the Kentucky League of Cities office at 100 East Vine Street, Suite 800, Lexington, KY 40507.

Kentucky School Boards Insurance Trust
Property and Liability Fund
Statements of Net Deficit
June 30, 2011 and 2010

	2011	2010
Assets		
Investment securities, at fair value	$ 6,369,842	$ 7,111,655
Cash and cash equivalents	3,687,546	2,497,370
Premium receivable (net of allowance for doubtful accounts of $20,000 and $73,987 in 2011 and 2010, respectively)	428,710	472,941
Reinsurance receivable	2,492,528	1,952,955
Receivable from related entity	77,161	15,471
Accrued investment income	51,825	68,972
Property and equipment (net of accumulated depreciation of $6,142 and $1,738 in 2011 and 2010, respectively)	15,893	15,642
Prepaid expenses	8,204	86,570
Total Assets	$ 13,131,709	$ 12,221,576
Liabilities and Net Deficit		
Unpaid Losses and Loss Adjustment Expenses		
Reported claims	$ 9,290,988	$ 8,803,053
Incurred but not reported claims	2,446,057	2,207,167
Total Unpaid Losses and Loss Adjustment Expenses	11,737,045	11,010,220
Accounts payable	209,125	519,327
Payable to related entity	1,795,501	769,409
Advance premiums	127,898	56,918
Total Liabilities	13,869,569	12,355,874
Net Deficit	(737,860)	(134,298)
Total Liabilities and Net Deficit	$ 13,131,709	$ 12,221,576

See accompanying notes.

Kentucky School Boards Insurance Trust
Property and Liability Fund
Statements of Revenues, Expenses and Changes in Net Deficit
Years Ended June 30, 2011 and 2010

	2011	2010
Operating Revenue		
Net premiums earned	$ 8,348,241	$ 6,974,689
Operating Expenses		
Losses and loss adjustment expenses	6,198,108	6,461,220
Commission expense	1,100,773	527,619
Claims administration expense	777,027	714,185
Loss prevention expenses	-	4,770
Professional fees	185,616	271,791
Program administrative fees	794,488	768,778
Other expenses	64,908	182,338
Total Operating Expenses	9,120,920	8,930,701
Operating Loss	(772,679)	(1,956,012)
Nonoperating Revenue		
Interest and investment revenue and gains, net	155,583	226,023
Other income	13,534	28,757
Total Nonoperating Revenue	169,117	254,780
Change in Net Deficit	(603,562)	(1,701,232)
Net Deficit, beginning of year	(134,298)	(933,066)
Capital surplus note	-	2,500,000
Net Deficit at End of Year	$ (737,860)	$ (134,298)

See accompanying notes.

Kentucky School Boards Insurance Trust
Property and Liability Fund
Statements of Cash Flows
Years Ended June 30, 2011 and 2010

	2011	2010
Cash Flows from Operating Activities		
Premiums collected	$ 8,463,452	$ 6,719,521
Losses and loss adjustment expenses paid	(5,471,283)	(5,672,367)
Underwriting expenses	(2,206,082)	(1,999,302)
Other payments	(519,333)	(81,458)
Net Cash Provided/(Used) by Operating Activities	266,754	(1,033,606)
Cash Flows from Investing Activities		
Purchases of investments	(24,722,797)	(25,062,858)
Proceeds from maturity of investments	2,291,254	4,841,560
Proceeds from sale of investments	23,167,304	16,702,883
Interest and dividends received	303,782	223,424
Net Cash Provided/(Used) by Investing Activities	1,039,543	(3,294,991)
Cash Flows from Capital and Financing Activities		
Surplus note	-	2,500,000
Interest paid	(125,000)	(60,274)
Other	13,534	28,757
Capital expenditures	(4,655)	(17,380)
Proceeds from disposal of equipment	-	50,122
Net Cash (Used)/Provided by Capital and Financing Activities	(116,121)	2,501,225
Net change in cash and cash equivalents during the year	1,190,176	(1,827,372)
Cash and cash equivalents at beginning of year	2,497,370	4,324,742
Cash and cash equivalents at end of year	$ 3,687,546	$ 2,497,370

See accompanying notes.

Kentucky School Boards Insurance Trust
Property and Liability Fund
Statements of Cash Flows (Continued)
Years Ended June 30, 2011 and 2010

	2011	2010
Reconciliation of Operating Loss to Net Cash Provided (Used) by Operating Activities:		
Operating Loss	$ (772,679)	$ (1,956,012)
Adjustments to reconcile operating loss to net cash provided (used) in operating activities:		
Depreciation	4,404	9,786
Provision for doubtful accounts	(53,987)	73,987
Changes in assets and liabilities:		
Premium receivable	98,218	(332,267)
Reinsurance receivable	(539,573)	942,410
Receivable from related entity	(61,690)	1,404,124
Prepaid expenses	78,366	(41,256)
Unpaid losses and loss adjustment expenses	726,825	(2,106,512)
Accounts payable	(310,202)	199,613
Payable to related entity	1,026,092	769,409
Advance premiums	70,980	3,112
Net Cash Provided/(Used) by Operating Activities	$ 266,754	$ (1,033,606)

See accompanying notes.

Note A – Nature of Organization and Operations

The Kentucky School Boards Insurance Trust (Trust) was organized by the Kentucky School Boards Association (Association), effective July 7, 1978. The Trust established a Property Insurance Fund to provide a program for property insurance coverage for Association members and their related agencies. The Trust also established a Liability Insurance Fund to provide a program for general liability, educator's legal liability, auto liability and auto physical damage (fleet) insurance coverage for Association members and their related agencies. The Board of Trustees subsequently determined that it would be in the best interest of its members to combine the two funds and, effective June 30, 2007, merged these two funds to form the Property and Liability Fund (the Fund). Management and the Board of Trustees believes that the merger creates a stronger program based on risk diversification between lines of coverage, and also allows for regulatory oversight of the property insurance program which did not previously exist. These financial statements represent the financial position, results of operations, change in net deficit and cash flows of the merged Fund. All school districts, non-profit institutions of higher education, and other tax supported agencies of Kentucky who are members of the Association are eligible to participate.

Participating members make contributions to the Fund based upon premium rates determined by the Fund. Members may be subject to contribution assessments in the event of deficiencies in the Fund's net assets. Members may withdraw from the Fund by giving sixty days written notice. The Fund can terminate coverage if it is unable to obtain acceptable excess reinsurance coverage, or for any reason, by giving ninety day notice. In the event the Fund terminates coverage, any amount remaining in the Property and Liability Fund, after payment of operational and administrative costs and claims for which coverage was provided, will be returned to members on a pro rata basis. As of June 30, 2011 and 2010, the Fund had 94 and 93 participants.

The Trust has also sponsored and organized a Workers' Compensation Fund and an Unemployment Compensation Fund.

Effective January 1, 2010, the Trust and the Kentucky League of Cities Insurance Service Association ("KLCIS") agreed on a plan under which KLCIS helps the Trust meet statutory surplus requirements for the Property and Liability Fund and Workers' Compensation Fund and KLCIS administers the Funds. In this agreement, KLCIS agreed to purchase from the Trust two surplus notes in the amount of $2,500,000 for the Property and Liability Fund and $5,500,000 for the Workers' Compensation Fund (see Note H). The proceeds of the surplus notes were applied by the Trust for the purpose of funding the existing deficit in the Funds. In the agreement, the Kentucky School Boards Association (KSBA) agreed to endorse exclusively the Property and Liability Fund and Workers' Compensation Fund and to provide certain services to the Funds at a fee equal to one and one-quarter percent (1.25%) of annual gross billed premiums of the funds, but not to exceed $500,000 in any fiscal year.

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

Legal/Regulatory Risk:

Legal/regulatory risk is the risk that changes in the legal or regulatory environment in which an insurer operates will occur and create additional losses or expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits or new legal theories may create 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.

Note A – Nature of Organization and Operations (Continued)

Credit Risk:

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

Interest Rate Risk:

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

Geographic Risk:

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

Note B – Summary of Significant Accounting Policies

1. <u>Basis of Presentation</u>: The Fund uses the accrual basis of accounting. Under this method, revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred.

   The Fund presents its financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units, with the exception of the surplus note, which has been included in net deficit as more fully described in NOTE H. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. As a proprietary activity, the Fund has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. Therefore, the Fund follows GASB pronouncements, Financial Accounting Standards Board (FASB) and predecessor boards' pronouncements issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements. The Fund also prepares its financial statements in accordance with accounting which Kentucky recognizes for determining solvency under Kentucky Insurance Law. Pursuant to Kentucky law, the DOI requires the Fund to report its financial condition using accounting principles generally accepted in the United States of America with certain prescribed exceptions as described above.

Note B – Summary of Significant Accounting Policies (Continued)

2. Use of 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 amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

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

   Management believes that the liability for unpaid losses and loss adjustment expenses is adequate. While management uses available information to estimate unpaid losses and loss adjustment expenses, future changes to the liability may be necessary based on claims experience and changing claims frequency and severity conditions, as well as changes in doctrines of legal liability and damage awards in Kentucky. The future changes will be charged or credited to expenses when they occur.

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

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

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

5. Accounts Receivable: In accordance with accounting practices generally accepted in the insurance industry, the Fund records audit premiums as of the fiscal year-end in which they were earned. The allowance for doubtful accounts is an amount that management believes will be adequate to absorb possible uncollectible accounts based on prior experience. Amounts are charged against the allowance when management determines that collectability is doubtful.

6. Property and Equipment: Property and equipment consists of furniture and fixtures. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. For the years ended June 30, 2011 and 2010, depreciation expense amounted to $4,404 and $9,786.

7. Premium Revenue: Premiums for contracts are recognized as earned on a pro rata basis over the contract period. Advance premiums relate to premiums paid by members for insurance coverage for the subsequent insurance period. Policy coverage is matched with revenue so as to result in recognition of profits over the life of the policies through establishment of reserves for incurred claims.

Note B – Summary of Significant Accounting Policies (Continued)

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

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

Note C – Deposits and Investments

The composition of the Fund's investment portfolio must meet certain criteria as set forth in the Kentucky Revised Statutes. Investments held by the Fund as of June 30, 2011 and 2010 are as follows:

	2011	**2010**
Cash and cash equivalents	$ 2,338,383	$ 1,127,748
Money market mutual funds	1,349,163	1,369,622
Deposits and investments classified as cash and cash equivalents	3,687,546	2,497,370
Certificates of deposit	50,022	-
Municipal bonds	2,575,031	2,640,357
Corporate bonds	360,172	-
U.S. government agency obligations	1,791,044	4,156,654
Equity mutual funds	1,593,573	314,644
Investments classified as investment securities	6,369,842	7,111,655
Total deposits and investments	$ 10,057,388	$ 9,609,025

Note C – Deposits and Investments (Continued)

As of June 30, 2011, KSBIT had the following investment maturities:

	Investment Maturities (in Years)			
	Less Than 1	1-5	6-10	More Than 10
Certificate of deposits	$ 50,022	$ -	$ -	$ -
Municipal bonds	-	834,906	419,501	1,320,624
Corporate bonds	-	-	360,172	-
U.S. government agency obligations	212,484	-	476,058	1,102,502
Total maturities	$ 262,506	$ 834,906	$ 1,255,731	$ 2,423,126

Interest and investment revenue is comprised of the following for the years ended June 30, 2011 and 2010:

	2011	**2010**
Interest and dividend income, net	$ 161,635	$ 204,733
Net realized and unrealized (loss) gain	(6,052)	21,290
	$ 155,583	$ 226,023

Credit Risk

State law requires that no individual equity holding shall comprise greater than 10% of the equity portion of the portfolio at the time of purchase. It also states that an investment in an individual holding shall not represent at the time of purchase more than 5% of the market value of the holding. Furthermore, state law requires that investments in equities shall not exceed 20% of the total market value of the portfolio of the self-insurance group at the time of purchase. In addition, mutual funds and exchange traded funds are allowable and shall not exceed 20% of the total market value of the portfolio at the time of purchase.

Note C – Deposits and Investments (Continued)

As of June 30, 2011 and 2010, the Fund's management believes the Fund is in compliance with all applicable laws. The Fund was invested in the following government agency bonds as of June 30, 2011: Federal Farm Credit Bank, Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Government National Mortgage Association and Federal National Mortgage Association. All of these bonds had AAA ratings. Additional investments included municipal bonds, all of which had AAA ratings, and money market accounts.

Custodial Credit Risk - Deposits

Federal law provides temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts at all FDIC-insured depository institutions through December 31, 2012. As of June 30, 2011 and 2010, the Fund has no deposits in excess of federally insured limits. Cash equivalents include investments in a money market fund that are not federally insured.

Note D – Reinsurance Coverage

The Fund's Board of Trustees authorized the purchase of reinsurance coverage in order to reduce the ultimate loss exposure arising from large losses in the Liability and Property Pools. The Fund purchases specific excess of loss reinsurance coverage for protection against losses in excess of specified amounts per occurrence. In addition to specific excess of loss reinsurance, the Fund also maintains aggregate reinsurance coverage. Policy limits vary based upon the type and amount of insured risk. Reinsurance premiums are based upon a percentage of average daily attendance, number of vehicles, or total insured values.

For 2011, the Fund purchased reinsurance coverage for the liability pool from ACE USA, a reinsurance carrier with a rating of "A+" (Superior) by A.M. Best and Company. The Fund purchased a buffer layer of reinsurance, defined as $650,000 in excess of $350,000, as specific reinsurance coverage per occurrence. The liability pool elected not to purchase aggregate reinsurance for 2011. For 2010, the liability pool maintained aggregate reinsurance coverage for all aggregated losses above $7,950,000.

Reinsurance coverage for the property pool for 2011 and 2010 is purchased from various reinsurers, each of which has been assigned a rating of A (Excellent) by A.M. Best and Company. In addition to purchasing specific excess of loss reinsurance for losses above $500,000, the property pool also maintains aggregate reinsurance coverage for all aggregate losses above $1,500,000. For 2011 and 2010, once the aggregate loss is reached, a $25,000 and $5,000 per claim deductible reduces the recoverable amount, respectively.

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

Reinsurance premiums ceded were $4,642,956 and $5,281,725 for the years ended June 30, 2011 and 2010, respectively. Reinsurance recoveries on paid claims during 2011 and 2010 were $768,790 and $2,447,966.

Note E – Liability for Unpaid Losses and Loss Adjustment Expenses

Activity in the liability for unpaid losses and loss adjustment expenses for the years ended June 30, 2011 and 2010 is summarized as follows:

	2011	2010
Net Unpaid Losses and Loss Adjustments Expenses, Beginning of Year	$ 11,010,220	$ 10,987,360
Incurred Losses and Loss Adjustment Expenses:		
Provision for insured events of the current year	6,968,613	5,602,204
(Decrease) increase in provision for insured events of prior years	(770,505)	859,016
Total incurred losses and loss adjustment expenses	6,198,108	6,461,220
Payments:		
Losses and loss adjustment expenses attributable to insured events of the current year	2,583,081	2,078,177
Losses and loss adjustment expenses attributable to insured events of prior years	2,888,202	4,360,183
Total Payments	5,471,283	6,438,360
Net Unpaid Losses and Loss Adjustment Expense, End of Year	$ 11,737,045	$ 11,010,220

A (decrease) increase in the provision for insured events of prior years signifies that the Fund expects higher than anticipated ultimate losses in the final disposition of claims.

Note F – Related Party Transactions

Through December 31, 2009, the Fund occupied office space from and had an Administrative Agreement with Kentucky School Board Association (KSBA) to provide management and administrative services for the Fund. As of January 1, 2010, the KSBA agreed to endorse exclusively the Fund and to provide certain services to the Fund at a fee equal to one and one-quarter percent (1.25%) of annual gross billed premiums of the funds, but not to exceed $500,000 in any fiscal year. The amounts paid to KSBA by the Fund were $161,174 and $458,121 for 2011 and 2010, respectively.

Note G – Commitments and Contingencies

The Fund is party to certain legal actions arising through the normal course of business. Management believes that these actions are without merit or that the ultimate liability, if any, will not materially affect the Fund's financial position or results of operations.

Note H – Surplus Note Agreement

In 2010, the Department of Insurance (DOI) approved the opportunity for the Kentucky League of Cities Insurance Service Association (KLCIS) to administer the Trust's program, provided that KLCIS issue an $8 million dollar surplus note receivable in exchange for an investment in the Trust. Of this total amount, $2.5 million was for the Property and Liability Fund and $5.5 million was for the Workers' Compensation Fund. The amount of the surplus note is classified as net assets by the Trust. Interest is due quarterly until the note is paid in full. Interest is calculated at a rate per annum which shall be equal to the sum of the year to date yield on the S&P Index weighted at twenty percent plus the year to date yield on the Bar Cap Index weighted at eighty percent. Provided, however, in no event shall the annual interest rate be less than one percent or greater than five percent. This note has no fixed maturity date. As the Trust gains increased financial stability, KLCIS will recover the entire $8 million dollars either through repayment or an alternate plan as deemed appropriate by the DOI.

Supplementary Information

Kentucky School Boards Insurance Trust Property and Liability Fund
Statement of Net Deficit Information
June 30, 2011

Assets	Liability Pool	Property Pool	Total
Investment securities, at fair value	$ 5,719,784	$ 650,058	$ 6,369,842
Cash and cash equivalents	2,756,626	930,920	3,687,546
Premium receivable, net	445,490	(16,780)	428,710
Reinsurance receivable	686,344	1,806,184	2,492,528
Receivable from related entity	-	77,161	77,161
Accrued investment income	48,974	2,851	51,825
Property and equipment, net	7,152	8,741	15,893
Prepaid expenses	2,978	5,226	8,204
Total Assets	$ 9,667,348	$ 3,464,361	$ 13,131,709
Liabilities and Net (Deficit) Assets			
Unpaid losses and loss adjustment expenses:			
Reported claims	$ 8,460,415	$ 830,573	$ 9,290,988
Incurred but not reported claims	2,362,267	83,790	2,446,057
Accounts payable	136,664	72,461	209,125
Payable to related entity	1,795,501	-	1,795,501
Advance premiums	70,594	57,304	127,898
Total Liabilities	12,825,441	1,044,128	13,869,569
Net (Deficit) Assets	(3,158,093)	2,420,233	(737,860)
Total Liabilities and Net (Deficit) Assets	$ 9,667,348	$ 3,464,361	$ 13,131,709

See accompanying independent auditor's report.

Kentucky School Boards Insurance Trust Property and Liability Fund
Statement of Net Deficit Information
June 30, 2010

Assets	Liability Pool	Property Pool	Total
Investment securities, at fair value	$ 7,046,561	$ 65,094	$ 7,111,655
Cash and cash equivalents	1,900,194	597,176	2,497,370
Premium receivable, net	469,721	3,220	472,941
Reinsurance receivable	516,652	1,436,303	1,952,955
Receivable from related entity	-	15,471	15,471
Accrued investment income	68,635	337	68,972
Property and equipment, net	6,348	9,294	15,642
Prepaid expenses	51,344	35,226	86,570
Total Assets	$ 10,059,455	$ 2,162,121	$ 12,221,576
Liabilities and Net (Deficit) Assets			
Unpaid losses and loss adjustment expenses:			
Reported claims	$ 8,513,342	$ 289,711	$ 8,803,053
Incurred but not reported claims	2,082,157	125,010	2,207,167
Accounts payable	357,226	162,101	519,327
Payable to related entity	769,409	-	769,409
Advance premiums	31,410	25,508	56,918
Total Liabilities	11,753,544	602,330	12,355,874
Net (Deficit) Assets	(1,694,089)	1,559,791	(134,298)
Total Liabilities and Net (Deficit) Assets	$ 10,059,455	$ 2,162,121	$ 12,221,576

See accompanying independent auditor's report.

Kentucky School Boards Insurance Trust Property and Liability Fund
Statement of Revenues, Expenses, and Changes in Net Deficit Information
June 30, 2011

	Liability Pool	Property Pool	Total
Operating Revenue			
Net premiums earned	$ 5,271,145	$ 3,077,096	$ 8,348,241
Total Operating Revenue	5,271,145	3,077,096	8,348,241
Operating Expenses			
Losses and loss adjustment expenses	5,166,900	1,031,208	6,198,108
Commission expense	650,685	450,088	1,100,773
Claims administration expense	482,638	294,389	777,027
Professional fees	110,201	75,415	185,616
Program administrative fees	468,508	325,980	794,488
Other expenses	3,952	60,956	64,908
Total Operating Expenses	6,882,884	2,238,036	9,120,920
Operating (Loss) Income	(1,611,739)	839,060	(772,679)
Nonoperating Revenue			
Interest and investment revenue and gains, net	140,748	14,835	155,583
Other income	6,987	6,547	13,534
Total Nonoperating Revenue	147,735	21,382	169,117
Change in Net (Deficit) Assets	(1,464,004)	860,442	(603,562)
Net (Deficit) Assets at Beginning of Year	(1,694,089)	1,559,791	(134,298)
Net (Deficit) Assets at End of Year	$ (3,158,093)	$ 2,420,233	$ (737,860)

See accompanying independent auditor's report.

Kentucky School Boards Insurance Trust Property and Liability Fund
Statement of Revenues, Expenses, and Changes in Net Deficit Information
June 30, 2010

	Liability Pool	Property Pool	Total
Operating Revenue			
Net premiums earned	$ 5,175,693	$ 1,798,996	$ 6,974,689
Total Operating Revenue	5,175,693	1,798,996	6,974,689
Operating Expenses			
Losses and loss adjustment expenses	5,082,341	1,378,879	6,461,220
Commission expense	317,563	210,056	527,619
Claims administration expense	453,211	260,974	714,185
Loss prevention expenses	-	4,770	4,770
Professional fees	157,482	114,309	271,791
Program administrative fees	471,085	297,693	768,778
Other expenses	84,359	97,979	182,338
Total Operating Expenses	6,566,041	2,364,660	8,930,701
Operating Loss	(1,390,348)	(565,664)	(1,956,012)
Nonoperating Revenue			
Interest and investment revenue and gains, net	223,744	2,279	226,023
Other income	28,757	-	28,757
Total Nonoperating Revenue	252,501	2,279	254,780
Change in Net (Deficit) Assets	(1,137,847)	(563,385)	(1,701,232)
Net (Deficit) Assets at Beginning of Year	(3,056,242)	2,123,176	(933,066)
Capital Surplus Note	2,500,000	-	2,500,000
Net (Deficit) Assets at End of Year	$ (1,694,089)	$ 1,559,791	$ (134,298)

See accompanying independent auditor's report.

KENTUCKY SCHOOL BOARDS INSURANCE TRUST PROPERTY AND LIABILITY FUND

Claims Development Information (*Unaudited*)

Years ended June 30, 2002 through 2011

The following table illustrates how the Association's earned premium revenue (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Association as of the end of each of the last ten years. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's gross premium revenue and investment revenue, premium revenue ceded to reinsurers, and net earned premium revenue and reported investment revenue. (2) This line shows each fiscal year's other operating costs of the Association including overhead and claims expense not allocable to individual claims. (3) This line shows the Association's gross incurred claims and allocated claims adjustment expenses, claims assumed by reinsurers, and net incurred claims and allocated adjustment expenses (both paid and accrued) as originally reported as of the end of the first year in which the event that triggered coverage under the contract occurred (called policy year). (4) This section shows the cumulative net amounts paid as of the end of successive years for each policy year. (5) This line shows the latest reestimated amount of claims assumed by reinsurers as of the end of the current year for each accident year. (6) This section shows how each policy year's net incurred claims increased or decreased as of the end of successive years (This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, and emergence of new claims not previously known). (7) This line compares the latest reestimated net incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of net claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts commonly is used to evaluate the accuracy of net incurred claims currently recognized in less mature policy years. The columns of the table show the data for successive policy years.

	Property Pool									
	Fiscal and Policy Year Ended									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
(1) Earned premium revenue and net investment income:	$ 1,296,816	$ 1,122,388	$ 1,397,295	$ 2,194,944	$ 2,777,819	$ 3,163,293	$ 2,073,833	$ 2,487,385	$ 1,801,275	$ 3,091,931
(2) Unallocated expenses	491,611	391,585	710,656	874,883	828,919	909,114	818,699	882,609	985,781	1,206,828
(3) Estimated incurred claims and expenses, end of policy year:	1,432,733	1,484,950	1,281,228	1,422,121	884,590	1,091,171	1,685,758	1,795,579	1,549,481	2,329,868
(4) Net paid (cumulative) as of:										
End of policy year	329,622	543,414	766,707	689,069	637,451	799,691	1,660,324	1,631,644	1,157,006	1,433,730
One year later	1,569,782	1,223,589	1,250,642	1,243,572	847,566	1,086,609	1,668,523	2,002,883	1,372,171	
Two years later	1,555,420	1,409,148	1,259,956	1,309,715	933,127	1,110,213	1,833,252	1,625,747		
Three years later	1,555,201	1,427,347	1,259,956	1,307,398	954,189	1,124,588	1,615,752			
Four years later	1,556,673	1,328,820	1,259,956	1,452,156	954,189	1,124,101				
Five years later	1,556,673	1,328,820	1,237,006	1,391,656	954,189					
Six years later	1,556,673	1,315,442	1,237,006	1,391,656						
Seven years later	1,561,362	1,315,442	1,218,906							
Eight years later	1,561,362	1,315,442								
Nine years later	1,561,362									
(5) Reestimated ceded claims and expenses	-	-	-	-	-	-	-	-	-	-
(6) Reestimated net incurred claims and expenses:										
End of policy year	1,432,733	1,484,950	1,281,228	1,422,121	884,590	1,091,171	1,685,758	1,795,579	1,549,481	2,329,868
One year later	1,624,715	1,251,130	1,284,120	1,252,969	964,028	1,153,111	1,673,435	2,018,105	1,422,871	
Two years later	1,558,328	1,422,782	1,259,956	1,312,513	972,922	1,134,332	1,833,964	1,625,747		
Three years later	1,556,673	1,428,692	1,259,956	1,309,235	954,189	1,130,901	1,615,752			
Four years later	1,556,673	1,328,820	1,259,956	1,455,694	954,189	1,135,118				
Five years later	1,556,673	1,328,820	1,237,006	1,391,656	954,189					
Six years later	1,556,673	1,315,442	1,237,006	1,391,656						
Seven years later	1,561,362	1,315,442	1,218,906							
Eight years later	1,561,362	1,315,442								
Nine years later	1,561,362									
(7) Increase (decrease) in estimated net incurred claims and expenses from the end of policy year	128,629	(169,508)	(62,322)	(30,465)	69,599	43,947	(70,006)	(169,832)	(126,610)	-

See accompanying independent auditor's report

KENTUCKY SCHOOL BOARDS INSURANCE TRUST PROPERTY AND LIABILITY FUND
Claims Development Information (*Unaudited*)
Years ended June 30, 2002 through 2011

Liability Pool
Fiscal and Policy Year Ended

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
(1) Earned premium revenue and net investment income:	$ 3,808,288	$ 5,390,001	$ 4,522,943	$ 5,111,929	$ 5,278,302	$ 5,887,269	$ 5,768,638	$ 5,190,053	$ 5,399,437	$ 5,536,893
(2) Unallocated expenses	747,025	1,221,249	1,371,039	1,632,868	1,806,516	1,478,398	1,255,018	1,277,964	1,543,973	1,840,984
(3) Estimated incurred claims and expenses, end of policy year:	3,747,967	4,360,528	4,270,835	4,176,833	4,536,098	4,601,400	5,142,590	4,838,423	4,052,723	4,638,745
(4) Net paid (cumulative) as of:										
End of policy year	791,996	972,173	949,245	1,060,386	1,361,906	1,183,603	1,856,197	1,200,757	921,171	1,149,351
One year later	1,357,151	2,178,174	1,744,849	2,363,995	2,315,467	2,314,647	2,971,865	2,389,290	1,905,954	
Two years later	2,009,099	3,396,876	2,838,751	2,655,463	3,059,396	2,831,529	4,111,595	2,891,291		
Three years later	2,306,521	4,367,935	2,904,455	2,867,014	3,478,913	2,997,897	5,250,185			
Four years later	2,475,229	4,935,519	3,357,588	3,119,087	4,017,483	3,432,701				
Five years later	2,543,862	5,254,516	3,470,197	3,251,081	4,349,791					
Six years later	2,742,202	5,400,429	3,631,120	3,427,585						
Seven years later	2,783,645	5,556,916	3,770,571							
Eight years later	2,844,679	5,645,539								
Nine years later	2,832,963									
(5) Reestimated ceded claims and expenses	-	-	-	-	-	-	-	-	-	-
(6) Reestimated net incurred claims and expenses:										
End of policy year	3,747,967	4,360,528	4,270,835	4,176,833	4,536,098	4,601,400	5,142,590	4,838,423	4,052,723	4,638,745
One year later	3,309,649	5,034,594	3,969,060	4,161,451	4,780,306	4,875,692	5,848,632	4,783,720	4,103,031	
Two years later	3,122,734	5,068,278	4,138,525	4,061,811	4,780,522	4,262,655	6,094,561	5,041,304		
Three years later	2,845,288	5,241,799	3,821,079	3,732,007	4,919,748	4,135,065	6,427,617			
Four years later	2,787,224	5,540,409	3,816,531	3,728,597	4,865,662	4,039,388				
Five years later	2,863,516	5,585,791	3,910,168	3,778,024	4,549,877					
Six years later	2,883,052	5,545,682	3,979,632	3,810,893						
Seven years later	2,919,017	5,716,375	3,966,839							
Eight years later	2,899,890	5,702,162								
Nine years later	2,887,826									
(7) Increase (decrease) in estimated net incurred claims and expenses from the end of policy year	(860,141)	1,341,634	(303,996)	(365,940)	13,779	(562,012)	1,285,027	202,881	50,308	-

See description of lines (1) through (7) on previous page.

See accompanying independent auditor's report