

**Kentucky League of Cities Unemployment
Compensation Reimbursement Trust**

Financial Statements

Years Ended June 30, 2011 and 2010

Kentucky League of Cities Unemployment Compensation Reimbursement Trust

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June 30, 2011 and 2010

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Independent Auditor's Report on Financial Statements

To the Board of Trustees of
Kentucky League of Cities Unemployment Compensation Reimbursement Trust

We have audited the accompanying statements of net assets of Kentucky League of Cities Unemployment Compensation Reimbursement Trust (the "Trust") as of June 30, 2011 and 2010 and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Trust'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 Trust'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, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky League of Cities Unemployment Compensation Reimbursement Trust as of June 30, 2011 and 2010 and the changes in its net assets 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 2 - 3 is presented for purposes of additional analysis and is not a required part of the financial statements but is supplementary information. This section has 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 it.

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January 5, 2012

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KENTUCKY LEAGUE OF CITIES UNEMPLOYMENT COMPENSATION REIMBURSEMENT TRUST

Management Discussion and Analysis

Our discussion and analysis of the Kentucky League of Cities Unemployment Compensation Reimbursement Trust (the Trust), provides an overview of the Trust'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 4.

Using This Annual Report

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

Statements of Net Assets

Table 1 shows all of the assets and liabilities of the Trust and is presented on the accrual basis. Total net assets decreased \$169,725 for the current fiscal year compared to a \$624,184 decrease during the prior fiscal year. The current fiscal year decrease in net assets is primarily due to the fact that the national unemployment climate continues to reflect an extremely high rate of lost jobs as well as the national trend to downsize or "lean up" on operations within organizations. Unemployment benefits continued to be extended, creating unexpected and unfunded mandates for cities/agencies. Please see additional information included under Statements of Revenues, Expenses, and Changes in Net Assets.

Table 1
Net Assets

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Cash and investments	\$ 4,773,287	\$ 4,669,932
Other assets	<u>622,826</u>	<u>489,432</u>
Total assets	\$ 5,396,113	\$ 5,159,364
Claims payable	\$ 501,053	\$ 660,405
Other liabilities	<u>792,201</u>	<u>226,375</u>
Total liabilities	\$ 1,293,254	\$ 886,780
Net assets	<u>\$ 4,102,859</u>	<u>\$ 4,272,584</u>

Kentucky League of Cities Unemployment Compensation Reimbursement Trust

Management Discussion and Analysis (Unaudited)

Statements of Revenues, Expenses and Changes in Net Assets

Table 2 shows the revenue and expenses of the Trust and is also presented on the accrual basis. Interest and investment income increased \$97,675 from the prior year, primarily due to being fully invested in securities for the duration of the year. During the previous year, the Trust maintained much greater balances in cash and cash equivalents, which earned very little returns. Benefit payments increased 2.6% for the current fiscal year as compared to a 51% increase in the prior fiscal year.

Table 2
Changes in Net Assets

	Year Ended June 30, 2011	Year Ended June 30, 2010
Participant deposits	\$ 1,799,144	\$ 1,480,447
Investment and other revenue, net of investment expenses	<u>130,671</u>	<u>32,996</u>
Total revenues	1,929,815	1,513,443
Benefit payments	1,914,496	1,865,508
Operating expenses	<u>177,650</u>	<u>184,755</u>
Total expenses	2,092,146	2,050,263
Return of net assets to cancelled members	(7,394)	(1,203)
Trust distributions	<u>-</u>	<u>(86,161)</u>
Change in net assets	<u>\$ (169,725)</u>	<u>\$ (624,184)</u>

Description of Current and Expected Conditions

Benefits payments are expected to remain high, but also continue to level off next year due to the continued economic focus on lowering unemployment rates nation-wide. Investment income is expected to decrease somewhat because of market devaluations on fixed income securities and the necessity to liquidate investments prior to reaching their optimum value at maturity to fund benefit payments. Each member's benefit payments only affect their own individual balances. Investment income is allocated to each member with a positive balance proportionate to the balance of the entire Trust.

Contacting the Trust's Financial Management

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

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Statements of Net Assets
June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets		
Cash and cash equivalents	\$ 127,596	\$ 4,290,576
Investment securities, at fair value	4,645,691	379,356
Accrued investment income	29,605	3,531
Receivable from participants, net of allowance of \$3,280 as of June 30, 2011 and 2010	<u>593,221</u>	<u>485,901</u>
Total Assets	<u>\$ 5,396,113</u>	<u>\$ 5,159,364</u>
Liabilities and Net Assets		
Payable to Commonwealth of Kentucky	\$ 501,053	\$ 660,405
Payable to related entity	786,201	134,214
Accrued trust distributions	-	86,161
Other liabilities	<u>6,000</u>	<u>6,000</u>
Total liabilities	1,293,254	886,780
Net assets	<u>4,102,859</u>	<u>4,272,584</u>
Total Liabilities and Net Assets	<u>\$ 5,396,113</u>	<u>\$ 5,159,364</u>

See accompanying notes.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenue		
Participant deposits	\$ 1,424,704	\$ 1,030,531
Reimbursement of participants' deficit balances	374,440	449,916
	<u>1,799,144</u>	<u>1,480,447</u>
Operating expenses		
Benefit payments	1,914,496	1,865,508
Other operating expenses	177,650	184,755
	<u>2,092,146</u>	<u>2,050,263</u>
Total Operating Expense		
	<u>2,092,146</u>	<u>2,050,263</u>
Operating Loss	(293,002)	(569,816)
Nonoperating revenue		
Interest and investment revenue and gains, net of investment expenses	130,671	32,996
	<u>130,671</u>	<u>32,996</u>
Loss Before Transfers and Distributions	(162,331)	(536,820)
Return of net assets to cancelled members	(7,394)	(1,203)
Trust distributions	-	(86,161)
	<u>-</u>	<u>(86,161)</u>
Change in Net Assets	(169,725)	(624,184)
Net Assets, Beginning of Year	4,272,584	4,896,768
	<u>4,272,584</u>	<u>4,896,768</u>
Net Assets, End of Year	<u>\$ 4,102,859</u>	<u>\$ 4,272,584</u>

See accompanying notes.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Statements of Cash Flows
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash Flows From Operating Activities		
Premiums collected	\$ 1,691,824	\$ 1,448,912
Benefits paid	(2,073,848)	(1,659,701)
Other payments	<u>474,337</u>	<u>78,621</u>
Net cash provided by (used in) operating activities	<u>92,313</u>	<u>(132,168)</u>
Cash Flows From Capital and Related Financing Activities		
Trust distributions paid and return of net assets to cancelled members	<u>(93,555)</u>	<u>(118,285)</u>
Cash Flows From Investing Activities		
Purchase of investments	(4,272,705)	(372,248)
Interest and dividends received	<u>110,967</u>	<u>23,524</u>
Net cash used in investing activities	<u>(4,161,738)</u>	<u>(348,724)</u>
Net change in cash and cash equivalents during the year	(4,162,980)	(599,177)
Cash and cash equivalents at beginning of year	<u>4,290,576</u>	<u>4,889,753</u>
Cash and cash equivalents at end of year	<u>\$ 127,596</u>	<u>\$ 4,290,576</u>

See accompanying notes.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Statements of Cash Flows - Continued
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of operating loss to net cash provided by (used in) operating activities:		
Operating loss	\$ (293,002)	\$ (569,816)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Changes in:		
Receivable from/payable to participants	(107,320)	(31,535)
Other assets	-	3,093
Receivable from related entity	651,987	260,286
Payable to Commonwealth of Kentucky	<u>(159,352)</u>	<u>205,804</u>
Net cash provided by (used in) operating activities	<u>\$ 92,313</u>	<u>\$ (132,168)</u>

See accompanying notes.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Notes to Financial Statements
June 30, 2011 and 2010

Note A – Nature of Organization and Operations

The Kentucky League of Cities Unemployment Compensation Reimbursement Trust (the Trust) was organized as a nonprofit trust by the Kentucky League of Cities, Inc. (KLC), effective January 1, 1979. The Trust was established as a service to KLC members and their related agencies who elect coverage (Participants) under the Kentucky Unemployment Compensation Amendments of 1976 and KRS 341.277. These statutes provide that governmental entities, in lieu of making contributions to the Kentucky Unemployment Compensation Fund, can elect to reimburse the Commonwealth of Kentucky (the Commonwealth) for all benefits paid to workers for compensable weeks of unemployment.

The Participants make quarterly deposits to the Trust based upon deposit rates determined by an actuary and approved by the Board of Trustees. Benefits paid by the Commonwealth are reimbursed by the Trust and charged to each participant's account. The Agreement of Participation provides that each participant is responsible for all benefits paid to its employees, and each participant is required to make additional deposits to the Trust if its deposits plus allocated investment income are less than benefits and allocated expenses charged to its account. Thus, the Trust assumes no liability for participant deficit balances, as it operates as a pool of self-insured members rather than as a group self-insurer. As of June 30, 2011 and 2010, participation in the Trust included 312 and 316 members, respectively.

Following is a description of the most significant risks facing the Trust and how the Trust 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 Trust 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 practices that identify and minimize the adverse impact of this risk.

Credit Risk:

Credit risk is the risk that issuers of securities owned by an insurer will default or that other parties that owe the insurer money will not pay. The Trust minimizes this risk by adhering to a conservative investment strategy, 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 Trust mitigates this risk by attempting to match the maturity schedule of its assets with the expected payouts of its liabilities. To the extent that such liabilities come due more quickly than assets mature, an insurer would have to sell assets prior to maturity and recognize a gain or loss.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Notes to Financial Statements (Continued)
June 30, 2011 and 2010

Note B – Summary of Significant Accounting Policies

1. Basis of Accounting: The Trust 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 Trust presents its financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. 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 Trust has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that Use Proprietary Fund Accounting*. Therefore, the Trust 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.

2. Accounting Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
3. Investment Securities: Investment securities consist of fixed income mutual funds, bonds, and other obligations of the U.S. Treasury and other corporations of the U.S. Government and are held by bank-administered trust funds. Investments are stated at fair value based 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 nonoperating 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 Trust considers all short-term investments with original maturities of three months or less to be cash equivalents.
5. Payable to Commonwealth of Kentucky: The liability for unemployment benefits payable to the Commonwealth represents quarterly benefits paid by the Commonwealth during the year that were reimbursed by the Trust subsequent to year end. The Trust does not recognize any liability for future benefits that may become payable relating to unemployment prior to year end, since each participant is ultimately liable for benefits paid to its employees.
6. Participant Accounts: Investment income, net of investment expenses, is allocated quarterly to participants based upon their pro rata share of the total net assets at the beginning of that quarter.

Operating expenses are allocated at the end of the year based upon the percentage of each participant's number of employees to the total number of employees for all participants.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Notes to Financial Statements (Continued)
June 30, 2011 and 2010

Note B – Summary of Significant Accounting Policies (Continued)

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

Note C – Deposits and Investments

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

	<u>2011</u>	<u>2010</u>
Deposits and investments classified as cash and cash equivalents	\$ 127,596	\$ 4,290,576
U.S. government agencies and municipal obligations	2,002,269	152,859
Corporate and foreign bonds	1,151,688	125,911
Fixed income equity mutual funds	<u>1,491,734</u>	<u>100,586</u>
Investments classified as investment securities	<u>4,645,691</u>	<u>379,356</u>
Total deposits and investments	<u>\$ 4,773,287</u>	<u>\$ 4,669,932</u>

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

	Investment Maturities (in Years)		
	<u>Less Than 1</u>	<u>1-5</u>	<u>Greater Than 5</u>
U.S. government agencies and municipal obligations	\$ -	\$ 122,992	\$ 1,879,277
Corporate and foreign bonds	<u>-</u>	<u>56,425</u>	<u>1,095,263</u>
Total maturities	<u>\$ -</u>	<u>\$ 179,417</u>	<u>\$ 2,974,540</u>

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

	<u>2011</u>	<u>2010</u>
Interest and dividend income, net of investment expenses	\$ 137,041	\$ 25,888
Unrealized and realized gains (losses) on sales of securities	<u>(6,370)</u>	<u>7,108</u>
	<u>\$ 130,671</u>	<u>\$ 32,996</u>

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Notes to Financial Statements (Continued)
June 30, 2011 and 2010

Note C – Deposits and Investments (Continued)

Credit Risk

As of June 30, 2011, the Trust was invested in several U.S. government agency bonds, state and local municipal bonds and corporate and foreign bonds, which have the following ratings as of June 30, 2011:

AAA	\$ 1,478,070
AA	486,164
A	776,983
Below A	412,740
	<u>\$ 3,153,957</u>

Custodial Credit Risk - Deposits

Cash equivalents include investments in a money market fund that are not federally insured.

Note D – Receivables from Participants

Amounts receivable from participants consist of the following as of June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Deposits for the three-month period ended June 30	\$ 387,908	\$ 259,534
Deficit balance reimbursements for the three-month period ended June 30	208,593	229,647
Less allowance for doubtful accounts	<u>(3,280)</u>	<u>(3,280)</u>
Total receivable from participants	<u>\$ 593,221</u>	<u>\$ 485,901</u>

The Agreement of Participation authorizes the Board of Trustees to require additional deposits from individual participants should their account reflect a deficit balance due to unfavorable experience or should the Trust become financially incapable of meeting its payment obligations. Deficit balances are billed to the participants quarterly, with reimbursements due within 30 days of notification.

Note E – Participant Deposits

Participants deposit to the Trust a percentage of the first \$6,000 in annual wages paid to each of their covered employees. The percentages range from 0% to 13.39% and are based upon the participants' past experience. To facilitate participants' quarterly reporting to the Trust, the current board-approved formula adjusts the annual deposit rate to allow quarterly calculations on gross wages.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Notes to Financial Statements (Continued)
June 30, 2011 and 2010

Note F – Service Bureau

The Trust has contracted with Talx, Inc. for unemployment compensation claims management services. Notification of payments due are submitted by the Commonwealth to Talx, Inc. who reviews the claims for validity and initiates a protest if applicable. Claims approved for payment by Talx, Inc. are then reported to the Trust and charged to the respective participant's account. For the year ended June 30, 2011, the fee for this service was \$10,430 per quarter, subject to a 3% increase each January 1st. This fee is charged to the participants' accounts in equal quarterly installments. Service bureau fees were \$42,360 and \$41,126 for years ended June 30, 2011 and 2010, respectively.

Note G – Related Party Transactions

During the years ended June 30, 2011 and 2010, KLC charged each Trust participant an administrative fee of \$7.00 per average full-time equivalent employee. The annual fee is charged to the participants' accounts in equal quarterly installments. The expense incurred by the Trust for this fee was \$126,188 and \$134,047 for the years ended June 30, 2011 and 2010, respectively.

All of the Trust's unemployment and administrative expenses and all of the Trust's members' premiums paid are paid from and deposited to KLC's operating account, respectively. Each month the Trust determines the amount of reimbursement due to or from KLC, and subsequently funds are transferred to satisfy the balance. The amount payable to KLC for unemployment and administrative expenses as of June 30, 2011 and 2010 was \$786,201 and \$134,214, respectively.

Included in the interest and investment revenue balance is interest revenue from a line of credit with KLC Premium Finance Company for the year ended June, 30, 2010. As of June 30, 2010, interest revenue from the line of credit was \$29,805. The interest rate was set annually by the Board of Directors, with no defined repayment schedule. There were no amounts outstanding at June 30, 2011 and 2010 under this line of credit. The line of credit agreement was not renewed for the year ended June 30, 2011.

Note H – Trust Distributions

For the years ended June 30, 2011 and 2010, due to an excess of net assets as determined by an actuarial study, the Board of Trustees authorized Trust distributions to participants of up to \$-0- and \$124,950, respectively. Actual trust distributions recognized were \$-0- and \$86,161, respectively. The Trust also authorized the return of \$7,394 and \$1,203 to members who elected to withdraw from the Trust during the years ended June 30, 2011 and 2010, respectively.

Kentucky League of Cities Unemployment Compensation Reimbursement Trust
Notes to Financial Statements (Continued)
June 30, 2011 and 2010

Note I – Other Operating Expenses

Other operating expenses consisted of the following for the years ended June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Service bureau fees	\$ 42,360	\$ 41,126
KLC administrative fees	126,188	134,047
Professional fees	6,500	6,000
Other expenses	<u>2,602</u>	<u>3,582</u>
	<u>\$ 177,650</u>	<u>\$ 184,755</u>