

Kentucky League of Cities, Inc. and Subsidiaries
Consolidated Financial Statements
Years Ended June 30, 2011 and 2010

Kentucky League of Cities, Inc. and Subsidiaries

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June 30, 2011 and 2010

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Mountjoy
Chilton
Medley

Independent Auditor's Report on Financial Statements

To the Board of Directors
Kentucky League of Cities, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Kentucky League of Cities, Inc. and Subsidiaries ("the Organization") as of June 30, 2011 and 2010 and the related consolidated statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky League of Cities, Inc. and Subsidiaries 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 4, 2011 on our consideration of Kentucky League of Cities, Inc. and Subsidiaries' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements that collectively comprise the Kentucky League of Cities, Inc. and Subsidiaries' financial statements as a whole. The consolidating information on pages 19-24 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 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 consolidated financial statements as a whole.

Montjoy Chilton Medley LLP

Lexington, Kentucky
October 4, 2011

Kentucky League of Cities, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

Our discussion and analysis of the Kentucky League of Cities, Inc. and Subsidiaries (KLC, Inc.) provides an overview of the Organization's financial activity for the fiscal year ended June 30, 2011. It should be read in conjunction with the consolidated financial statements, which begin on page 6.

Financial Highlights

- Operating revenues in total increased approximately \$198,400 over last fiscal year. Commission revenue, which decreased approximately \$247,200, was more than offset with increases in both administrative fees and conference income. The increase in administrative fees was primarily due to the administrative fee of the KSBIT program being in effect for the entire fiscal year. Conference revenue returned to its historic level.
- Operating expenses increased approximately \$220,000 primarily due to increases in retirement costs, meetings expenses for several trainings that are held on a biennial basis and building maintenance due to the HVAC system.
- Earnings from investments increased approximately \$102,000 over the prior year.
- New Cities Institute was no longer an affiliate of KLC as of March 31, 2011. The In-Kind Contribution decreased approximately \$457,500 compared to last fiscal year.

Using this Annual Report

This report consists of a series of financial statements. The consolidated balance sheet on page 6 provides information about the Organization as a whole.

Balance Sheets

Table 1 shows all of the assets and liabilities of the Organization and is presented on the accrual basis. The total net assets increased by \$933,434 as compared to an increase of \$635,208 from the prior year. This increase is primarily due to an increase in non-operating revenues.

Table 1
Net Assets

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Current assets	\$ 12,427,882	\$ 12,395,507
Capital and other assets	<u>8,231,253</u>	<u>8,800,335</u>
Total Assets	20,659,135	21,195,842
Current liabilities	6,824,821	8,039,056
Long-term liabilities	<u>3,918,721</u>	<u>4,174,627</u>
Total Net Assets	<u>\$ 9,915,593</u>	<u>\$ 8,982,159</u>

Kentucky League of Cities, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

Statement of Revenues, Expenses and Changes in Net Assets

Table 2 shows all the revenues and expenses of the Organization and is also presented on the accrual basis. The administrative fee for providing staffing and overhead to the KLC related entities (KMFC, KLCIS, KLCUCRT, KLCWCT, KSBIT) increased approximately \$400,000 primarily due to the administration of the KSBIT program for an entire fiscal year. Administrative and General expenses increased approximately \$763,000 over last fiscal year due primarily to absorbing the personnel costs associated with New Cities Institute and increased retirement costs. Total operating expenses increased approximately \$220,000 over the prior year.

**Table 2
Revenues, Expenses and Changes in Net Assets**

	Year Ended June 30, 2011	Year Ended June 30, 2010
Operating Revenues		
Administrative fees	\$ 7,589,943	\$ 7,184,140
Commissions	2,235,039	2,482,247
Member dues	447,849	449,500
Conference income	278,904	233,495
Premium finance revenue	162,507	155,913
Other income	403,241	430,685
Publication income	22,325	5,461
Total Operating Revenues	11,139,808	10,941,441
Operating Expenses		
Administrative and general	(5,552,228)	(4,789,438)
In-kind contributions to NewCities Institute	(221,376)	(678,846)
Legislative services	(777,022)	(731,362)
Member financial services	(320,196)	(290,414)
Member insurance services	(4,491,723)	(4,699,651)
Member meeting and training services	(254,856)	(207,550)
Total operating expenses	(11,617,401)	(11,397,261)
Nonoperating Revenues	1,411,027	1,091,028
Change in Net Assets	\$ 933,434	\$ 635,208

Kentucky League of Cities, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

Description of Current and Expected Conditions

Effective January 1, 2010 the Kentucky School Boards Insurance Trust (KSBIT) entered into an administrative agreement with KLC for KLC to provide day-to-day management of the business affairs and provide necessary office, facilities, staff, and administrative services for the Liability/Property and Workers' Compensation Trusts. KLC shall be reimbursed for all administrative costs plus a percentage of premiums. Fiscal Year 2011 was the first full fiscal year for the administration of this program. The KLC Executive Board hired Jonathan "Jon" Steiner as KLC Executive Director/CEO effective November 1, 2010 and Debra Gabbard was hired as CFO effective April 2011.

The management of KLC, Inc. is not aware of any other significant changes in conditions that would have a significant effect on the financial position or results of operations of the organization in the near future.

Contacting KLC Inc.'s Financial Management

This financial report is designed to provide a general overview of KLC Inc.'s finances and to show KLC Inc.'s accountability to its members. If you have questions about this report or need additional financial information, contact KLC Inc.'s office at 100 E. Vine St., Lexington, KY 40507.

Kentucky League of Cities, Inc. and Subsidiaries
Consolidated Balance Sheets
June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 1,676,517	\$ 2,582,032
Investments	5,303,890	4,418,724
Accounts receivable	592,299	1,168,689
Premiums receivable	76,369	82,401
Prepaid expenses and other assets	482,787	368,721
Due from related parties	4,296,020	3,774,940
	<u>12,427,882</u>	<u>12,395,507</u>
Total Current Assets		
Fixed Assets		
Land	674,175	674,175
Building	6,427,420	6,427,420
Furniture & Fixtures	2,740,475	2,804,207
Improvements	4,326,432	4,250,569
	<u>14,168,502</u>	<u>14,156,371</u>
Less accumulated depreciation		
	<u>(5,937,249)</u>	<u>(5,356,036)</u>
Total Fixed Assets		
	<u>8,231,253</u>	<u>8,800,335</u>
Total Assets		
	<u>\$ 20,659,135</u>	<u>\$ 21,195,842</u>
Liabilities and Net Assets		
Current Liabilities		
Current maturities of bond payable	\$ 255,905	\$ 125,373
Accounts payable	140,250	149,404
Accrued liabilities	1,036,553	946,237
Deferred income/revenue	518,368	597,466
Due to related parties	4,873,745	6,220,576
	<u>6,824,821</u>	<u>8,039,056</u>
Total Current Liabilities		
Bond payable, net of current maturities		
	<u>3,918,721</u>	<u>4,174,627</u>
Total Liabilities		
	10,743,542	12,213,683
Net Assets		
Invested in fixed assets net of related debt	4,056,627	4,500,335
Unrestricted	5,858,966	4,481,824
	<u>9,915,593</u>	<u>8,982,159</u>
Total Net Assets		
	<u>\$ 20,659,135</u>	<u>\$ 21,195,842</u>
Total Liabilities and Net Assets		
	<u>\$ 20,659,135</u>	<u>\$ 21,195,842</u>

See accompanying notes

Kentucky League of Cities, Inc. and Subsidiaries
Consolidated Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating Revenues		
Administrative fee - KLCIS	\$ 3,564,878	\$ 3,795,712
Administrative fee - KLCWCT	1,807,264	1,924,289
Administrative fee - KMFC	896,575	741,721
Administrative fee - KLCUCRT	126,188	134,047
Administrative fee - KSBIT	1,195,038	588,371
Commissions	2,235,039	2,482,247
Member dues	447,849	449,500
Conference income	278,904	233,495
Premium finance revenue	162,507	155,913
Other	403,241	430,685
Publication income	22,325	5,461
	<u>11,139,808</u>	<u>10,941,441</u>
 Total Operating Revenues	 11,139,808	 10,941,441
 Operating Expenses	 <u>11,617,401</u>	 <u>11,397,261</u>
Operating Income (Loss)	(477,593)	(455,820)
Nonoperating Revenues (Expenses)		
Interest and investment income	689,557	587,521
Interest expense	(58,226)	(167,986)
Gain on sale of fixed assets	90,442	23,308
Net rental income	689,254	648,185
	<u>1,411,027</u>	<u>1,091,028</u>
 Total Nonoperating Revenues	 1,411,027	 1,091,028
 Change in Net Assets	 933,434	 635,208
Net Assets at Beginning of Year	<u>8,982,159</u>	<u>8,346,951</u>
Net Assets at End of Year	<u>\$ 9,915,593</u>	<u>\$ 8,982,159</u>

See accompanying notes

Kentucky League of Cities, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash Flows From Operating Activities		
Cash received from members and affiliates	\$ 9,777,465	\$ 6,760,839
Cash paid to suppliers and employees	<u>(10,984,406)</u>	<u>(10,684,438)</u>
Net Cash Provided (Used) by Operating Activities	(1,206,941)	(3,923,599)
Cash Flows From Noncapital Financing Activities		
Proceeds from draws on line of credit	6,000,000	4,850,000
Payments on line of credit	<u>(6,000,000)</u>	<u>(4,850,000)</u>
Net Cash Provided by Noncapital Financing Activities	-	-
Cash Flows From Capital and Related Financing Activities		
Capital expenditures	(198,718)	(101,339)
Proceeds from sale of fixed assets	113,890	11,942
Principal payments on bond payable	(125,374)	(4,240,000)
Proceeds from bond payable	-	4,300,000
Interest paid	<u>(58,226)</u>	<u>(167,986)</u>
Net Cash Used by Capital and Related Financing Activities	(268,428)	(197,383)
Cash Flows From Investing Activities		
Proceeds from sale and maturity of investments	4,377,041	3,925,388
Interest and income (loss) on investments	687,310	585,078
Purchase of investments	(5,262,207)	(4,404,199)
Proceeds from rental activities	988,003	985,295
Cash paid to maintain rental property	<u>(220,293)</u>	<u>(337,110)</u>
Net Cash Provided by Investing Activities	<u>569,854</u>	<u>754,452</u>
Net Decrease in Cash and Cash Equivalents	(905,515)	(3,366,530)
Cash and Cash Equivalents at Beginning of Year	<u>2,582,032</u>	<u>5,948,562</u>
Cash and Cash Equivalents at End of Year	<u>\$ 1,676,517</u>	<u>\$ 2,582,032</u>

See accompanying notes

Kentucky League of Cities, Inc. and Subsidiaries
Consolidated 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 Used by		
Operating Activities		
Operating loss	\$ (477,593)	\$ (455,820)
Adjustments to reconcile operating loss to net cash provided by (used by) operating activities:		
Depreciation	663,531	665,274
Depreciation allocated as in-kind contribution	6,353	18,698
Amortization of employee supplemental retirement loans	-	2,443
Changes in assets and liabilities:		
Accounts receivable	578,634	(724,042)
Premiums receivable	6,032	4,776
Prepaid expenses and other assets	(118,051)	125,809
Due from/to related parties	(1,867,911)	(3,428,917)
Accounts payable	(9,154)	63,611
Accrued liabilities	90,316	(163,012)
Deferred income/revenue	(79,098)	(32,419)
Net Cash Used by Operating Activities	<u>\$ (1,206,941)</u>	<u>\$ (3,923,599)</u>

See accompanying notes

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2011 and 2010

Note A – Nature of Organization and Operations

The Kentucky League of Cities, Inc. and Subsidiaries (KLC, Inc.) is an incorporated association of cities whose purpose is to provide legislative, financial, insurance, and legal assistance to its members. This is primarily accomplished through lobbying, publications and training seminars. KLC, Inc. publishes a monthly newsletter and a weekly bulletin on the status of legislation. KLC, Inc.'s revenues are substantially comprised of fees earned for administration of entities related to KLC, Inc. and member dues. Member dues are based on the members' respective populations.

Kentucky League of Cities Insurance Agency (KLCIA) was incorporated on December 27, 1995 by its sole stockholder KLC, Inc. KLC, Inc. owns 100% of the outstanding common stock of KLCIA. KLCIA was organized to transact business as an insurance agency. KLCIA sells health, life, and bonding insurance to municipalities in the Commonwealth of Kentucky and also markets insurance offered by other KLC, Inc. related entities.

Kentucky League of Cities Premium Finance Company (KLCPFC) was incorporated on March 26, 2003 by its sole stockholder KLC, Inc. KLC, Inc. owns 100% of the outstanding common stock of KLCPFC. KLC, Inc. capitalized KLCPFC with a \$200,000 transfer. KLCPFC was organized to finance insurance premiums for member cities. See Note G for further information on KLCPFC's activities.

The consolidated financial statements of KLC, Inc. include the accounts of KLC, Inc., KLCIA, and KLCPFC. All significant intercompany balances and transactions have been eliminated upon consolidation.

The following entities are KLC, Inc. related entities:

- Kentucky Municipal Finance Corporation (KMFC)
- Kentucky League of Cities Insurance Services (KLCIS)
- Kentucky League of Cities Unemployment Compensation Reimbursement Trust (KLCUCRT)
- Kentucky League of Cities Workers Compensation Trust (KLCWCT)
- NewCities Institute, Inc.
- Kentucky School Boards Insurance Trust Workers Compensation Fund (KSBITWCF)
- Kentucky School Boards Insurance Trust Property and Liability Fund (KSBITPLF)

Note B – Summary of Significant Accounting Policies

1. Estimates: The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America which require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The following is a summary of the significant accounting policies consistently followed by KLC, Inc. in the preparation of its consolidated financial statements.
2. Basis of Presentation: KLC, Inc. 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, KLC, Inc. has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. Therefore, KLC, Inc. follows GASB pronouncements and Financial Accounting Standards Board and predecessor boards' pronouncements issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements.

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2011 and 2010

Note B – Summary of Significant Accounting Policies (Continued)

Operating revenues are those revenues that are generated from the primary operations. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations. All other expenses are reported as non-operating expenses.

3. Cash and Cash Equivalents: Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.
4. Investments: Investment securities consist of U.S. government agencies, equity securities, and mutual funds consisting of governmental securities and debt and equity securities. Investments are stated at fair value based, generally, on quoted market prices.

Realized gains and losses on investments are calculated as the difference between the proceeds of the sale and the original cost of the investments sold. This calculation is independent of the calculation of the net change in the fair value of investments. Realized gains and losses on investments that were held in prior years and sold in the current year were included as a net change in the fair value of investments as reported in the prior year.

5. Fixed Assets: Fixed assets consist of land, buildings, furniture and equipment and building improvements and are stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets.

<u>Asset Type</u>	<u>Useful Life</u>
Buildings	39 years
Furniture and equipment	2-15 years
Building and building improvements	15-20 years

When properties are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the account with any resulting gain or loss reflected in income.

6. Income Taxes: The Internal Revenue Service (IRS) has ruled that the income of KLC, Inc. 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.
7. Deferred Income/Revenue: Deferred revenue consists of KLC, Inc. members' dues and premiums financed through KLCPF. Members' annual dues are billed in advance throughout the year. These dues are deferred and subsequently recognized on a pro-rata basis. Total deferred revenue related to members' dues was \$297,583 and \$287,104 as of June 30, 2011 and 2010, respectively. KLCPF finances insurance premiums for members of KLCIS throughout the year. Those premium amounts that are received in advance of the policy period are classified as advanced (deferred) revenue until earned. Total unearned premiums as of June 30, 2011 and 2010 were \$37,262 and \$92,085, respectively. Deferred revenue also includes convention, administrative fees, advertising fees and rent received in advance. Total other deferred revenue for KLC, Inc. as of June 30, 2011 and 2010 was \$171,470 and \$183,257, respectively.

Additionally, KLCIA has received commissions from certain insurance carriers for advance premiums sold to member cities. These commissions are earned over the life of the premium policy period. Total deferred revenue for KLCIA as of June 30, 2011 and 2010 was \$12,053 and \$35,020, respectively.

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2011 and 2010

Note C – Deposits and Investments

KLC, Inc. maintains its cash balances with a financial institution located in Central Kentucky. These balances are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. Additionally, non-interest bearing accounts are fully insured by the FDIC. At June 30, 2011, KLC, Inc. had uninsured balances of approximately \$489,000. At June 30, 2010 KLC Inc. had no uninsured balances. Cash equivalents include investments in a money market fund that are not federally insured.

Deposits and investments held by KLC, Inc. as of June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 1,547,962	\$ 2,451,609
Money market mutual funds	<u>128,555</u>	<u>130,423</u>
Deposits and investments classified as cash and cash equivalents	<u>1,676,517</u>	<u>2,582,032</u>
U.S. government agencies and municipal obligations	2,095,974	846,313
Corporate and foreign bonds	591,382	551,502
Bond and fixed income mutual funds	230,038	826,746
Equity mutual funds	475,159	847,193
Equity securities	<u>1,911,337</u>	<u>1,346,970</u>
Investments classified as investment securities	<u>5,303,890</u>	<u>4,418,724</u>
Total deposits and investments	<u>\$ 6,980,407</u>	<u>\$ 7,000,756</u>

Investment and interest revenue and gains for assets limited to use, cash equivalents, and other investments are comprised of the following for the years ended June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Investment and interest revenue and gains:		
Interest and dividend income	\$ 118,381	\$ 122,259
Realized gains on sales of securities	5,412	49,356
Unrealized gains on securities	<u>565,764</u>	<u>415,906</u>
	<u>\$ 689,557</u>	<u>\$ 587,521</u>

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2011 and 2010

Note C – Deposits and Investments (Continued)

Interest Rate Risk

Interest rate risk is the risk that interest rates will change and cause a decrease in the value of an entity's investments. KLC, Inc. does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

Credit risk is the risk that issuers of securities owned by an entity will default or that other parties that owe the entity money will not pay. KLC minimizes these risks by adhering to a conservative investment strategy, by utilizing sound financial advice of reputable investment advisors, by maintaining credit and collection policies, and by providing an allowance for any amounts deemed uncollectible.

As of June 30, 2011, KLC was invested in several U.S. government agency bonds, state and local municipal bonds and bond mutual funds which have the following ratings as of June 30, 2011:

AAA	\$ 814,451
AA	13,846
A	1,375,160
Below A	<u>122,555</u>
	<u>\$ 2,326,012</u>

Concentration of Credit Risk

During 2008 KLC, Inc. implemented an investment policy that limited investments in any single holding to no more than 5% of the market value of the account, as well as setting guidelines for the type and quality of investments. At June 30, 2011 KLC had one investment which exceeded the 5% limit as approved by the Board. As of 2010, KLC, Inc. was in compliance with this policy.

As of June 30, 2011 KLC, Inc. 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	\$ -	\$ -	\$ 895,974
Corporate and foreign bonds	-	<u>56,238</u>	<u>535,144</u>
Total maturities	<u>\$ -</u>	<u>\$ 56,238</u>	<u>\$ 1,431,118</u>

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2011 and 2010

Note D – Bond Payable

On March 1, 2006, KLC, Inc. issued an adjustable rate, taxable 2006 series bond in the amount of \$5,000,000. On December 1, 2009, this bond payable was refinanced by three 15-year variable rate bonds. Repayment on these bonds began January 1, 2011. The interest rate on the bond as of June 30, 2011 was 0.30%. The bonds are included in bond pools that are administered by KLC, Inc. (see Note H). The bonds bear interest at variable rates based on the SIFMA municipal index. In order to secure the loan, KLC, Inc. pledged the following as security for the loan repayment: all rental income derived from the building, \$2,000,000 of KLC's investments, and a negative lien pledge/covenant on the building. The following is a schedule of the required future principal payments in accordance with the refinancing agreement.

Year Ending June 30:	
2012	\$ 255,905
2013	263,598
2014	271,369
2015	279,443
2016	287,633
Thereafter	<u>2,816,678</u>
	<u>\$ 4,174,626</u>

In December 2009, KLC, Inc. terminated an interest swap agreement that was related to the refinanced bond debt. KLC, Inc. paid approximately \$100,000 to the interest rate swap provider which represented the difference between the fixed rate and the specified variable rate applicable to the outstanding principal of the bond at the termination date.

Note E – Line of Credit

Beginning July 1, 2010, KLC, Inc. entered into a \$6,000,000 line of credit agreement with a non-related party financial institution. The line of credit carries an interest rate of 4.00% and matured on June 30, 2011. KLC, Inc. was a guarantor on the line of credit.

Beginning July 1, 2011, KLC, Inc. entered into a \$6,000,000 line of credit agreement with a non-related party financial institution. The line of credit carries a variable interest rate based on 30-day LIBOR plus 2.2% and matures on June 30, 2012. KLC, Inc. is a guarantor on the line of credit.

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2011 and 2010

Note F – Employee Deferred Compensation Plan

Prior to April 1994, KLC, Inc. offered its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 in which KLC, Inc. contributed 10% of the participant's annual salary. In April 1994, KLC, Inc. created a plan in accordance with Internal Revenue Code Section 401(a) and ceased contributions to the 457 plan. The 457 plan remains as a strictly voluntary plan and all full-time employees are eligible to participate from the time of hire. Employees may contribute up to a maximum of \$15,000 per year. The 401(a) plan was available to all full-time employees who had completed one year of service. KLC, Inc. made contributions to the 401(a) plan of 10% of the eligible participant's annual salary. KLC, Inc.'s previous contributions to the deferred compensation plan are not available to participants until termination, retirement, death, or in the event of an unforeseeable emergency. At its June 20, 2000 meeting, to be effective September 1, 2000, the KLC, Inc. Executive Board passed a resolution to permit its eligible, full-time employees to participate in the County Employees Retirement System (CERS), a cost-sharing multiple-employer defined benefit plan, established and maintained by the Kentucky Retirement System, an agency of the Commonwealth of Kentucky. CERS provides retirement benefits to plan members and beneficiaries. Employees hired prior to September 1, 2000 can participate in either the 401(a) plan or the CERS plan. The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for CERS. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601. Employees hired after September 1, 2000 can only participate in the CERS plan.

Under the provisions of the Kentucky Revised Statute Section 61.645, the Board of Trustees of the Kentucky Retirement Systems administers CERS and has the authority to establish and amend benefit provisions.

Plan members are required to contribute 5%, if hired prior to September 1, 2008, or 6% if hired subsequent to September 1, 2008, of their annual covered compensation and KLC, Inc. is required to contribute an actuarially determined rate. The current rate is 16.93% (16.16% for 2010) of the employee's total covered compensation. The contribution requirements of Plan members and KLC, Inc. are established and may be amended by the Kentucky Retirement System's Board of Trustees. During the years ended June 30, 2011 and 2010, KLC, Inc. contributed \$987,511 and \$924,020, respectively, to the retirement plan in effect.

Note G – Premium Financing Activities

As mentioned in Note A to the consolidated financial statements, KLCPFC was organized to finance insurance premiums for member cities that purchase property, liability and workers compensation insurance from KLCIS and KLCWCT (the Insurance Companies), respectively. KLCPFC enters into short-term financing agreements with member cities who wish to finance their premiums over a period of time. The length of the financing contracts range from three to nine months and the finance charges range from 4.99% to 8.75% for 2011 and for 2010 depending on the dollar amount of the premium financed. KLCPFC also requires a 20% down payment on all amounts financed.

When a member signs a financing contract, KLCPFC recognizes a receivable from the member city and a payable to the Insurance Companies. Premium amounts financed are transferred on a monthly basis to the Insurance Companies. Should a member be cancelled or withdraw from the insurance plans, KLCPFC would receive the unearned amount of the premium from the Insurance Companies. KLCPFC recognizes premium finance revenue as earned based upon the terms of the contract. Total finance income for June 30, 2011 and 2010 was \$162,507 and \$155,913. Total premiums receivable as of June 30, 2011 and 2010 were \$76,369 and \$82,401. Total premiums due from (owed to) the Insurance Companies as of June 30, 2011 and 2010 were \$162,150 and (\$32,710), respectively and are included within the due to related entities on the consolidated balance sheet.

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2011 and 2010

Note H – Administration Fees

KLC, Inc. acts as administrator for several sponsored insurance funds. The Kentucky League of Cities Unemployment Compensation Reimbursement Trust (KLCUCRT) provides unemployment compensation coverage to KLC, Inc. members and pays KLC, Inc. an administration fee of \$7.00 per average full time employee covered, less expenses allocated to the KLCUCRT program. Kentucky League of Cities Insurance Services (KLCIS) operates various self-insurance programs for participating municipalities and pays KLC, Inc. an administration fee based on a percentage of earned premiums. In 1994, KLC, Inc. instituted the Kentucky League of Cities Workers' Compensation Trust (KLCWCT) for the purpose of creating and operating various self-insurance, insurance and investment trusts. KLC, Inc. provides substantially all operational, management and administrative services under an administrative agreement with KLCWCT. KLCWCT pays fees to KLC, Inc. based on a percentage of earned premiums.

Beginning January 1, 2010 KLC, Inc. provides substantially all of the operational, management and administrative services for the Kentucky School Boards Insurance Trust Workers Compensation Fund and Kentucky School Boards Insurance Trust Property and Liability Fund in exchange for an administrative service fee based on allocated costs plus a percentage of earned premiums.

KLCIA has also entered into a marketing agreement with KLCIS and KLCWCT which provides that KLCIS and KLCWCT pay a commission to KLCIA for insurance which KLCIA markets. Revenues generated during the years ended June 30, 2011 and 2010 were approximately \$917,000 and \$1,078,000 respectively.

KLC, in 1989, formed the Kentucky Municipal Finance Corporation (KMFC) for the purpose of issuing tax exempt bonds to finance or refinance member city projects. In 1989 the City of Danville, on KMFC's behalf, issued \$152 million in tax exempt bonds with the proceeds to be pooled and loaned to member cities. As administrator to the program, KLC receives an ongoing fee of .25% of the principal amount of the bonds outstanding. During 2009, the letter of credit provider of the Danville bond pool decided to redeem the \$152 million in outstanding tax exempt bonds. The bonds were fully redeemed on July 15, 2010.

In the mid 1990's KLC formed the Finance Trust to oversee future bond pools. Since that time KLC, through various member cities, has issued approximately \$450 million to finance or refinance member city projects. As the administrator to the program, KLC receives an ongoing fee of .25% of the outstanding balance of loans made out of the program. In limited instances KLC receives an upfront administrative fee instead of an on-going administrative fee. Any up-front fees are recognized into revenue evenly over a 10 year period.

For the year ended June 30, 2011, KLC has issued approximately \$47 million in bonds. The new bond pool structure is a dedicated bond pool instead of a blind bond pool with all administrative fees being earned upfront.

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2011 and 2010

Note I – Due From/To Related Parties

Related party receivables and payables included within KLC, Inc.'s consolidated balance sheet consist primarily of the following as of June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
KLCIS accounts payable	\$ (4,873,745)	\$ (6,220,576)
KLCWCT accounts receivable (payable)	3,509,820	3,640,688
KLCUCRT accounts (payable) receivable	786,200	134,216
NewCities Institute	-	36
	<u> </u>	<u> </u>
Net due from (due to) related parties	<u>\$ (577,725)</u>	<u>\$ (2,445,636)</u>
KSBIT - WCF accounts receivable	\$ 151,843	\$ 378,049
KSBIT - PCF accounts receivable	161,901	320,315
	<u> </u>	<u> </u>
Included in accounts receivable	<u>\$ 313,744</u>	<u>\$ 698,364</u>

Note J – NewCities Institute, Inc.

KLC, Inc. donated \$221,376 and \$678,846 in services to NewCities Institute, Inc. during 2011 and 2010, respectively. During 2011, NewCities Institute, Inc. repaid \$25,000 to KLC, Inc. KLC, Inc. recorded the payments as other income in the statement of revenues, expenses and changes in net assets. There were no such payments budgeted or made during 2010. KLC Inc. had a service and license agreement with NewCities Institute and under the agreement, KLC, Inc. performed all administrative and general services for NewCities Institute, Inc. at no cost to the Institute. In February 2011, KLC decided not to renew the agreement beyond June 30, 2011.

Kentucky League of Cities, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
June 30, 2011 and 2010

Note K - Expenses

Expenses for 2011 and 2010 by natural classification are as follows:

	2011	2010
Salaries	\$ 6,165,925	\$ 5,760,871
Retirement	987,511	924,020
Employee benefits	732,101	724,942
Depreciation	669,884	683,972
Professional services	635,826	619,818
Payroll taxes	432,226	424,846
Other expenses	415,905	396,398
Meetings	349,488	275,122
Building management	256,527	235,236
In-kind contributions to NewCities Institute, Inc.	221,376	678,846
Legislative services	123,282	168,605
Travel	122,962	113,966
Telephones	87,909	88,321
Program and development	84,563	55,950
Office supplies	84,509	66,983
Dues	64,565	60,204
KLCPFC finance expenses	54,431	29,805
Bond administration	53,140	25,130
Publications	47,300	31,664
Postage	27,971	32,562
	<u>\$ 11,617,401</u>	<u>\$ 11,397,261</u>

Expenses for 2011 and 2010 by functional classification are as follows:

	2011	2010
Administrative and general	\$ 5,552,228	\$ 4,789,438
Member insurance services	4,491,723	4,699,651
Legislative services	777,022	731,362
Member financial services	320,196	290,414
Member meeting and training services	254,856	207,550
In-kind contributions to NewCities Institute, Inc.	221,376	678,846
	<u>\$ 11,617,401</u>	<u>\$ 11,397,261</u>

Supplementary Information

Kentucky League of Cities, Inc. and Subsidiaries
Consolidating Balance Sheets
June 30, 2011

	Kentucky League of Cities, Inc.	Kentucky League of Cities Insurance Agency	Kentucky League of Cities Finance Company	Consolidating Entries	Consolidated Total
Assets					
Current Assets					
Cash and cash equivalents	\$ 1,270,417	\$ -	\$ 406,100	\$ -	\$ 1,676,517
Investments	5,603,890	-	-	(300,000)	5,303,890
Accounts receivable	436,933	155,366	-	-	592,299
Premiums receivable	-	-	76,369	-	76,369
Prepaid expenses and other assets	444,692	32,634	5,461	-	482,787
Due from related parties	4,296,020	84,299	162,150	(246,449)	4,296,020
Total Current Assets	12,051,952	272,299	650,080	(546,449)	12,427,882
Fixed Assets					
Land	674,175	-	-	-	674,175
Building	6,427,420	-	-	-	6,427,420
Furniture & Fixtures	2,699,848	19,227	21,400	-	2,740,475
Improvements	4,326,432	-	-	-	4,326,432
Less accumulated depreciation	14,127,875	19,227	21,400	-	14,168,502
	(5,898,574)	(17,275)	(21,400)	-	(5,937,249)
Total Fixed Assets	8,229,301	1,952	-	-	8,231,253
Total Assets	\$ 20,281,253	\$ 274,251	\$ 650,080	\$ (546,449)	\$ 20,659,135

Kentucky League of Cities, Inc. and Subsidiaries
Consolidating Balance Sheets
June 30, 2011

	Kentucky League of Cities, Inc.	Kentucky League of Cities Insurance Agency	Kentucky League of Cities Premium Finance Company	Consolidating Entries	Consolidated Total
Liabilities and Net Assets					
Current Liabilities					
Current maturities of bond payable	\$ 255,905	\$ -	\$ -	\$ -	\$ 255,905
Accounts payable	109,089	26,120	5,041	-	140,250
Accrued liabilities	978,758	49,795	8,000	-	1,036,553
Deferred income/revenue	469,053	12,053	37,262	-	518,368
Due to related parties	5,120,194	-	-	(246,449)	4,873,745
Total Current Liabilities	6,932,999	87,968	50,303	(246,449)	6,824,821
Bond payable, net of current maturities	3,918,721	-	-	-	3,918,721
Total Liabilities	10,851,720	87,968	50,303	(246,449)	10,743,542
Net Assets					
Invested in fixed assets net of related debt	4,054,675	1,952	-	-	4,056,627
Unrestricted	5,374,858	184,331	599,777	(300,000)	5,858,966
Total Net Assets	9,429,533	186,283	599,777	(300,000)	9,915,593
Total Liabilities and Net Assets	\$ 20,281,253	\$ 274,251	\$ 650,080	\$ (546,449)	\$ 20,659,135

See independent auditor's report

Kentucky League of Cities, Inc. and Subsidiaries
Consolidating Balance Sheets
June 30, 2010

	Kentucky League of Cities, Inc.	Kentucky League of Cities Insurance Agency	Kentucky League of Cities Finance Company	Consolidating Entries	Consolidated Total
Assets					
Current Assets					
Cash and cash equivalents	\$ 1,964,105	\$ -	\$ 617,927	\$ -	\$ 2,582,032
Investments	4,718,724	-	-	(300,000)	4,418,724
Accounts receivable	957,405	211,284	-	-	1,168,689
Premiums receivable	-	-	82,401	-	82,401
Prepaid expenses and other assets	317,131	46,128	5,462	-	368,721
Due from related parties	3,807,650	26,187	-	(58,897)	3,774,940
Total Current Assets	11,765,015	283,599	705,790	(358,897)	12,395,507
Fixed Assets					
Land	674,175	-	-	-	674,175
Building	6,427,420	-	-	-	6,427,420
Furniture & Fixtures	2,763,580	19,227	21,400	-	2,804,207
Improvements	4,250,569	-	-	-	4,250,569
Less accumulated depreciation	14,115,744	19,227	21,400	-	14,156,371
	(5,321,264)	(13,372)	(21,400)	-	(5,356,036)
Total Fixed Assets	8,794,480	5,855	-	-	8,800,335
Total Assets	\$ 20,559,495	\$ 289,454	\$ 705,790	\$ (358,897)	\$ 21,195,842

Kentucky League of Cities, Inc. and Subsidiaries
Consolidating Balance Sheets
June 30, 2010

	Kentucky League of Cities, Inc.	Kentucky League of Cities Insurance Agency	Kentucky League of Cities Premium Finance Company	Consolidating Entries	Consolidated Total
Liabilities and Net Assets					
Current Liabilities					
Current maturities of bond payable	\$ 125,373	\$ -	\$ -	\$ -	\$ 125,373
Accounts payable	95,279	49,083	5,042	-	149,404
Accrued liabilities	938,617	(380)	8,000	-	946,237
Deferred income/revenue	470,361	35,020	92,085	-	597,466
Due to related parties	6,246,763	-	32,710	(58,897)	6,220,576
Total Current Liabilities	7,876,393	83,723	137,837	(58,897)	8,039,056
Bond payable, net of current maturities	4,174,627	-	-	-	4,174,627
Total Liabilities	12,051,020	83,723	137,837	(58,897)	12,213,683
Net Assets					
Invested in fixed assets net of related debt	4,494,480	5,855	-	-	4,500,335
Unrestricted	4,013,995	199,876	567,953	(300,000)	4,481,824
Total Net Assets	8,508,475	205,731	567,953	(300,000)	8,982,159
Total Liabilities and Net Assets	\$ 20,559,495	\$ 289,454	\$ 705,790	\$ (358,897)	\$ 21,195,842

See independent auditor's report

Kentucky League of Cities, Inc. and Subsidiaries
Consolidating Statements of Revenues, Expenses, and Changes in Net Assets
Year Ended June 30, 2011

	Kentucky League of Cities, Inc.	Kentucky League of Cities Insurance Agency	Kentucky League of Cities Premium Finance Company	Consolidating Entries	Consolidated Total
Operating Revenues					
Administrative fee - KLCIS	\$ 3,564,878	\$ -	\$ -	\$ -	\$ 3,564,878
Administrative fee - KLCWCT	1,807,264	-	-	-	1,807,264
Administrative fee - KMFC	896,575	-	-	-	896,575
Administrative fee - KLCUCRT	126,188	-	-	-	126,188
Administrative fee - Financial services	75,000	-	-	(75,000)	-
Administrative fee - KSBIT	996,670	198,368	-	-	1,195,038
Commissions	2,293,797	2,235,039	-	(2,293,797)	2,235,039
Member dues	447,849	-	-	-	447,849
Conference income	278,904	-	-	-	278,904
Premium finance revenue	-	-	162,507	-	162,507
Other	160,809	230,859	11,573	-	403,241
Publication income	22,325	-	-	-	22,325
Total Operating Revenues	10,670,259	2,664,266	174,080	(2,368,797)	11,139,808
Operating Expenses	11,157,902	2,684,918	143,378	(2,368,797)	11,617,401
Operating Income (Loss)	(487,643)	(20,652)	30,702	-	(477,593)
Nonoperating Revenues (Expenses)					
Interest and investment gain	687,231	1,204	1,122	-	689,557
Interest expense	(58,226)	-	-	-	(58,226)
Gain on sale of fixed assets	90,442	-	-	-	90,442
Net rental income	689,254	-	-	-	689,254
Total Nonoperating Revenues (Expenses)	1,408,701	1,204	1,122	-	1,411,027
Change in Net Assets	921,058	(19,448)	31,824	-	933,434
Net Assets at Beginning of Year	8,508,475	205,731	567,953	(300,000)	8,982,159
Net Assets at End of Year	\$ 9,429,533	\$ 186,283	\$ 599,777	\$ (300,000)	\$ 9,915,593

See independent auditor's report

Kentucky League of Cities, Inc. and Subsidiaries
Consolidating Statements of Revenues, Expenses, and Changes in Net Assets
Year Ended June 30, 2010

	Kentucky League of Cities, Inc.	Kentucky League of Cities Insurance Agency	Kentucky League of Cities Premium Finance Company	Consolidating Entries	Consolidated Total
Operating Revenues:					
Administrative fee - KLCIS	\$ 3,795,712	-	-	-	\$ 3,795,712
Administrative fee - KLCWCT	1,924,289	-	-	-	1,924,289
Administrative fee - KMFC	741,721	-	-	-	741,721
Administrative fee - KLCUCRT	134,047	-	-	-	134,047
Administrative fee - Financial services	75,000	-	-	(75,000)	-
Administrative fee - KSBIT	493,980	94,391	-	-	588,371
Commissions	2,492,420	2,482,248	-	(2,492,421)	2,482,247
Member dues	449,500	-	-	-	449,500
Conference income	233,495	-	-	-	233,495
Premium finance revenue	-	-	155,913	-	155,913
Other	111,575	307,083	12,027	-	430,685
Publication income	5,461	-	-	-	5,461
Total Operating Revenues	10,457,200	2,883,722	167,940	(2,567,421)	10,941,441
Operating Expenses	10,937,892	2,908,051	118,739	(2,567,421)	11,397,261
Operating Income (Loss)	(480,692)	(24,329)	49,201	-	(455,820)
Nonoperating Revenues (Expenses)					
Interest and investment loss	585,561	803	1,157	-	587,521
Interest expense	(167,986)	-	-	-	(167,986)
Gain on sale of fixed assets	23,308	-	-	-	23,308
Net rental income	648,185	-	-	-	648,185
Total Nonoperating Revenues (Expenses)	1,089,068	803	1,157	-	1,091,028
Change in Net Assets	608,376	(23,526)	50,358	-	635,208
Net Assets at Beginning of Year	7,900,099	229,257	517,595	(300,000)	8,346,951
Net Assets at End of Year	\$ 8,508,475	\$ 205,731	\$ 567,953	\$ (300,000)	\$ 8,982,159

See independent auditor's report



Mountjoy
Chilton
Medley

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

To the Board of Directors
Kentucky League of Cities, Inc. and Subsidiaries

We have audited the financial statements of Kentucky League of Cities, Inc. and Subsidiaries as of and for the year ended June 30, 2011, and have issued our report thereon dated October 4, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Kentucky League of Cities, Inc. and Subsidiaries' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Kentucky League of Cities, Inc. and Subsidiaries' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Kentucky League of Cities, Inc. and Subsidiaries' internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Kentucky League of Cities, Inc. and Subsidiaries' financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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We noted certain matters that we reported to management of Kentucky League of Cities, Inc. and Subsidiaries in a separate letter dated October 4, 2011.

This report is intended solely for the information and use of management, the Board of Directors, and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and the distribution is unlimited.

M. Puntjey Chilton Medley LLP

Lexington, Kentucky
October 4, 2011