KENTUCKY LEAGUE OF CITIES
INSURANCE SERVICES ASSOCIATION
Financial Statements and Supplementary Information

Years Ended June 30, 2013 and 2012
with Report of Independent Auditors

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DEAN DORTON ALLEN FORD, PLLC

Report of Independent Auditors

Board of Trustees
Kentucky League of Cities Insurance Services Association
Lexington, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Kentucky League of Cities Insurance Services Association (KLCIS) which comprise the statements of net position as of June 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky League of Cities Insurance Services Association as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 - 5 be presented to supplement the basic financial statements. Such information, although not a required part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the 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 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 audits 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.

Other Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise KLCIS' basic financial statements. The accompanying supplementary information on pages 22 - 23 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such 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 supplementary information has been subjected to the auditing procedures applied in the audit of the 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 supplementary information is fairly stated in all material respects in relation to the financial statements taken as a whole.

The supplementary information on pages 24 - 25 is presented for purposes of additional analysis and is not a required part of the financial statements but is supplementary information required by the Department of Insurance of the Commonwealth of Kentucky. Such 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 not been subjected to the auditing procedures applied in the audits of the financial statements. Accordingly, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 6, 2013 on our consideration of KLCIS' 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering KLCIS' internal control over financial reporting and compliance.

Dean Dotton Allen Ford, PLLC

November 6, 2013
Lexington, Kentucky

Kentucky League of Cities Insurance Services Association

Management's Discussion and Analysis *(Unaudited)*

Our discussion and analysis of the Kentucky League of Cities (KLC) Insurance Services Association (KLCIS) provides an overview of KLCIS' financial activity for the fiscal year ended June 30, 2013. 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. The statements of net position on page 6 provides information about KLCIS as a whole.

Statements of Net Position

Table 1 shows all of the assets and liabilities of KLCIS and is presented on the accrual basis. The total net position increased $4,898,596 for the current fiscal year, compared to the increase of $1,720,864 during the prior fiscal year. The current year's increase was largely attributable to favorable loss development in prior fund years.

Table 1
Net Position

	2013	2012
Cash and investments	$ **41,743,510**	$ 31,589,253
Capital and other assets	**3,173,802**	9,512,773
Total assets	**44,917,312**	41,102,026
Unpaid losses and loss adjustment expenses	**26,189,269**	26,671,988
Other liabilities	**2,769,773**	3,370,364
Total liabilities	**28,959,042**	30,042,352
Total net position	$ **15,958,270**	$ 11,059,674

Statement of Revenues, Expenses and Changes in Net Position

Table 2 shows all the revenues and expenses of KLCIS and is also presented on the accrual basis. Net earned premium revenue increased $1,791,687 or 9.47% from the prior fiscal year. Total investment related revenues increased $366,267 or 44.59%, due to an increase in realized gains and a decrease in unrealized losses in the current fiscal year. Total loss and loss adjustment expenses were less than expected, resulting in a decrease of $1,591,309. General administrative expenses increased by 7.13% due to an increase in professional and service fees compared to fiscal year 2012.

Table 2
Change in Net Position

Year ended June 30,		2013		2012
Net premiums earned	$	**20,719,779**	$	18,928,092
Investment and other revenue and gains		**1,187,655**		821,388
Total revenue		**21,907,434**		19,749,480
Losses and loss adjustment expenses		**8,416,142**		10,007,451
General administrative expenses		**8,592,696**		8,021,165
Total expenses		**17,008,838**		18,028,616
Change in net position	$	**4,898,596**	$	1,720,864

Description of Current and Expected Conditions

In the last few years, KLC has taken measures to fine tune the efforts of loss control, underwriting and claims. KLCIS has allocated additional resources to each of these areas in the form of closer management oversight of third party administrators, in house loss control staff and additional emphasis on membership accountability of results via underwriting activities. KLC has conducted training programs specifically designed for newly elected officials, which has helped reduce employment related claims. We have increased loss control visits particularly in the law enforcement area where claim frequency and severity can dramatically impact results. Additional resources have been allocated to fine tune the score card program and to equip members with the resources necessary to effectively conduct monthly safety meetings. We believe the synergistic effect of these three departments are contributing to the favorable results. Favorable results are only possible with the continued support and cooperation of the KLCIS membership.

Contacting the Organization's Financial Management

This financial report is designed to provide a general overview of 2013's finances and to show the KLCIS' 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 LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Statements of Net Position

June 30, 2013 and 2012

	2013	2012
Assets		
Investment securities, at fair value	$ 35,652,693	$ 29,131,857
Cash and cash equivalents	6,090,817	2,457,396
Accounts receivable, net of allowance for doubtful accounts of $16,000 in both 2013 and 2012	129,703	160,670
Reinsurance receivable	1,746,594	2,174,913
Receivable from related entities	-	5,868,927
Accrued investment income	153,484	149,170
Prepaid expenses	249,501	274,850
Membership in NLC Mutual Insurance Company	620,037	620,037
Property and equipment, net of accumulated depreciation of $894,999 and $1,100,223 for 2013 and 2012, respectively	274,483	264,206
Total assets	44,917,312	41,102,026
Liabilities		
Unpaid losses and loss adjustment expenses:		
Reported claims	$ 14,391,271	$ 13,518,810
Incurred but not reported claims	10,860,244	12,312,836
Unallocated loss adjustment expenses	937,754	840,342
Total unpaid losses and loss adjustment expenses	26,189,269	26,671,988
Accounts payable	294,277	177,837
Payable to related entities	26,184	-
Advance premiums	2,449,312	3,192,527
Total liabilities	28,959,042	30,042,352
Net Position		
Net position	$ 15,958,270	$ 11,059,674

See accompanying notes.

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Statements of Revenues, Expenses and Changes in Net Position

Years ended June 30, 2013 and 2012

	2013	2012
Operating revenue:		
Net premiums earned	$ **20,719,779**	$ 18,928,092
Operating expenses:		
Losses and loss adjustment expenses	**8,416,142**	10,007,451
Commission expense	**2,867,795**	2,633,600
Claims administration expense	**1,082,238**	1,060,444
Loss prevention expenses	**294,364**	223,531
Professional fees	**463,479**	250,983
Administrative fees, related entity	**3,541,689**	3,539,918
Other expenses	**343,131**	312,689
Total operating expenses	**17,008,838**	18,028,616
Operating income	**3,710,941**	899,476
Nonoperating revenue:		
Interest and investment revenue	**1,139,135**	785,886
Other income	**48,520**	35,502
Total nonoperating revenue	**1,187,655**	821,388
Change in net position	**4,898,596**	1,720,864
Net position, beginning of year	**11,059,674**	9,338,810
Net position, end of year	$ **15,958,270**	$ 11,059,674

See accompanying notes.

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Statements of Cash Flows

Years ended June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Premiums collected	$ 20,002,531	$ 19,916,212
Losses and loss adjustment expenses paid	(8,898,861)	(10,734,968)
Underwriting expenses paid	(1,462,656)	(9,780,574)
Other payments	(587,307)	(383,849)
Net cash provided by (used in) operating activities	9,053,707	(983,179)
Cash flows from investing activities:		
Purchases of investments	(23,105,408)	(24,303,140)
Proceeds from maturity of investments	1,774,121	7,459,370
Proceeds from sale of investments	14,719,251	17,744,261
Interest and dividends received	1,226,021	941,880
Net cash (used in) provided by investing activities	(5,386,015)	1,842,371
Cash flows from capital and related financing activities:		
Purchase of property and equipment	(82,791)	(216,176)
Other	48,520	35,502
Net cash used in financing activities	(34,271)	(180,674)
Net increase in cash and cash equivalents	3,633,421	678,518
Cash and cash equivalents, beginning of year	2,457,396	1,778,878
Cash and cash equivalents, end of year	$ 6,090,817	$ 2,457,396

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Statements of Cash Flows, continued

Years ended June 30, 2013 and 2012

		2013		2012
Reconciliation of operating income to net cash provided by (used in) operating activities:				
Operating income	$	**3,710,941**	$	899,476
Adjustments:				
Depreciation		**72,514**		40,680
Provision for doubtful accounts		**5,000**		-
Increase (decrease) in cash due to changes in:				
Accounts receivable		**25,967**		42,795
Reinsurance receivable		**428,319**		(1,327,901)
Receivable from related entities		**5,868,927**		(995,180)
Prepaid expenses		**25,349**		109,123
Unpaid losses and loss adjustment expenses		**(482,719)**		(727,517)
Accounts payable		**116,440**		30,020
Payable to related entities		**26,184**		-
Advance premiums		**(743,215)**		945,325
Net cash provided by (used in) operating activities	$	**9,053,707**	$	(983,179)

See accompanying notes.

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Notes to the Financial Statements

1. Description of Organization

Kentucky Municipal Risk Management Association was established in April 1987 under the authorization of the Kentucky Interlocal Cooperation Act of the Kentucky Revised Statutes for the purpose of creating and operating various self-insurance, insurance and investment trusts. It is an unincorporated, nonprofit association voluntarily established by the participating cities, urban-county governments and related public agencies and political subdivisions within the Commonwealth of Kentucky. During 2003, the Association changed its name to Kentucky League of Cities Insurance Services Association (KLCIS).

KLCIS has received a Certificate of Filing from the Department of Insurance of the Commonwealth of Kentucky but is exempt from most statutory requirements that commercial insurers must follow. KLCIS' general objectives are to formulate, develop and administer, on behalf of the member political subdivisions, a program of insurance liability coverage as well as auto physical damage coverage for participating municipalities (the liability pool). All coverages are written on an occurrence basis. In addition, KLCIS operates a property insurance program for participating municipalities (the property pool). Participation in the liability and property pools included 408 and 357 members, respectively, as of June 30, 2013, and 376 and 329 members, respectively, as of June 30, 2012.

Following is a description of the most significant risks facing property/casualty insurers and how KLCIS 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. KLCIS 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.

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. KLCIS 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.

1. Description of Organization, continued

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. KLCIS 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 insurer would have to sell assets prior to maturity and recognize a gain or loss. KLCIS 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 KLCIS does business. KLCIS writes all of its business in Kentucky. KLCIS mitigates this risk by adhering to specified underwriting practices and by obtaining catastrophic reinsurance coverage.

2. Summary of Significant Accounting Policies

Basis of Accounting

KLCIS 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.

KLCIS 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 Fund has adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.* Therefore, the Fund follows GASB pronouncements and all Financial Accounting Standards Board and predecessor boards' pronouncements except those that conflict with or contradict GASB pronouncements.

For 2013, KLCIS implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.*

GASB Statement No. 63 identifies net position, rather than net assets, as the residual of all other elements presented in a statement of financial position. This change was incorporated in KLCIS's 2013 financial statements; however, there was no effect on beginning net position/fund balance.

2. Summary of Significant Accounting Policies, continued

Use of 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.

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 footnote 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.

Investment Securities

Investment securities consist of fixed maturity debt and equity securities that KLCIS 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 nonoperating revenue.

The investment in the NLC Mutual Insurance Company is carried at cost as required by the Kentucky Department of Insurance.

Cash and Cash Equivalents

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

2. Summary of Significant Accounting Policies, continued

Accounts Receivable

In accordance with accounting principles generally accepted in the insurance industry, KLCIS 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.

Property and Equipment

Property and equipment consists of furniture and fixtures, including computer equipment and software net of accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets.

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.

Unpaid Losses and Loss Adjustment Expenses

Unpaid losses and loss adjustment expenses are based on estimates of the ultimate cost of claims (including future claims adjustment expense) 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 cost 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 reflects 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.

To reflect its present value, the liability for unpaid losses and loss adjustment expenses has been discounted at 3% for both 2013 and 2012. Discounting reduced the liability by $1,440,273 and $1,616,716 as of June 30, 2013 and 2012, respectively. The effect of discounting on the provision for losses and loss adjustment expenses was an increase of $176,443 and $18,365 in 2013 and 2012, respectively.

2. Summary of Significant Accounting Policies, continued

Reinsurance

Reinsurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums, losses, and loss adjustment expenses are reported net of reinsured amounts. KLCIS evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. KLCIS holds funds and collateral as security under reinsurance agreements in the form of letters of credit for any reinsurers not subject to the regulation of the Kentucky Commissioner of Insurance. In the opinion of management, all amounts due from reinsurers at June 30, 2013 and 2012 are recoverable.

Net Position

KLCIS' Board of Trustees may, at its discretion, refund to members the savings, if any, resulting from operations of KLCIS in the form of dividends or reduced premiums. The amount of any future dividends or reductions in premiums is dependent of KLCIS' ultimate liability for claims incurred and, accordingly, the amount may differ from net position. No refunds were issued during 2013 or 2012.

KLCIS has received initial capital contributions from members to provide start-up surplus. Capital contributions were primarily determined based on a percentage of current annual premiums. Capital contributions are refundable only at the discretion of the Board of Trustees.

In the event of adverse loss experience, KLCIS can assess additional amounts to the members. An assessment would be computed and established by the Board of Trustees with each member's share being in proportion to their annual premiums relative to premiums of all members. There have been no assessments levied since the inception of KLCIS.

Federal Income Taxes

The Internal Revenue Service has ruled that the income of KLCIS 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.

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through November 6, 2013, the date that the financial statements were available to be issued. There were no events occurring during the evaluation period that require recognition or disclosure in the financial statements.

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Notes to the Financial Statements, continued

3. Deposits and Investments

The composition of KLCIS' investment portfolio must meet certain criteria as set forth in the Kentucky Revised Statutes. Investments held by KLCIS as of June 30, 2013 and 2012 are as follows:

	2013	2012
Deposits and investments classified as cash and cash equivalents:		
Cash and cash equivalents	$ **1,934,765**	$ 753,382
Money market mutual funds	**4,156,052**	1,704,014
	6,090,817	2,457,396
Investments classified as investment securities:		
Certificates of deposit	**1,491,856**	1,494,175
Corporate bonds	**9,122,208**	8,099,277
Municipal bonds	**6,391,476**	6,823,067
U.S. government agency obligations	**6,337,085**	6,834,824
Equity mutual funds	**4,602,147**	2,547,801
Equity securities	**7,707,921**	3,332,713
	35,652,693	29,131,857
Total deposits and investments	$ **41,743,510**	$ 31,589,253

As of June 30, 2013 KLCIS had the following investment maturities in years:

	Less than 1	1-5	6-10	More than 10
Certificates of deposit	$ **1,243,494**	$ **248,362**	$ **-**	$ **-**
Corporate bonds	**1,110,154**	**5,712,854**	**2,299,200**	**-**
Municipal bonds	**1,122,886**	**5,083,012**	**185,578**	**-**
U.S. government agency obligations	**16,434**	**538,655**	**2,143,103**	**3,638,893**
Total maturities	$ **3,492,968**	$ **11,582,883**	$ **4,627,881**	$ **3,638,893**

3. Deposits and Investments, continued

Interest and investment revenue is comprised of the following for the years ended June 30, 2013 and 2012:

	2013	2012
Interest and dividend income	$ **698,171**	$ 775,583
Realized gains on sales of securities	**532,164**	135,522
Unrealized losses on securities	**(91,200)**	(125,219)
	$ **1,139,135**	$ 785,886

Credit Risk

Pursuant to state law, no more that 20% of admitted assets may be invested in medium and lower grade investments; no more than 10% of admitted assets may be invested in lower grade securities; investments with a rating of 5 or 6 from a nationally recognized statistical rating organization (NRSRO) cannot exceed 3% of admitted assets; investments with a rating of 6 from NRSRO cannot exceed 1% of admitted assets. KLCIS' internal investment policy does not allow the purchase of medium or lower grade investments; however, investments already owned may be retained when the rating drops from high grade to medium or lower grades.

State law and KLCIS' policy both state that total medium and lower grade investments issued, assumed, guaranteed, accepted or insured by any one organization (or as to asset back securities, any interest in a single asset or pool of assets) may not exceed 1% of admitted assets. KLCIS' policy further states that total medium grade holdings tied to a single source shall be limited to 1% of total assets. State law and KLCIS' policy both require that no more than 3% of admitted assets shall be invested in any single asset or, for asset backed securities, any single pool of assets.

State law requires that no individual equity holding shall comprise greater that 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 that 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 that are registered investment advisors licensed by the Securities Exchange Commission and Commonwealth of Kentucky to perform investment services are allowable and shall not exceed 20% of the total market value of the portfolio at the time of purchase.

As of June 30, 2013, KLCIS was invested in the following government agency bonds; Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, and Government National Mortgage Association. Of these bonds that were rated, all had AAA ratings. KLCIS also invested in corporate bonds which ranged in ratings from B to AA2. Additional investments included U.S. Treasury notes and bonds, bond mutual funds, and municipal bonds, all of which had AA2 to AAA ratings.

3. Deposits and Investments, continued

Custodial Credit Risk - Deposits

KLCIS maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. KLCIS has not experienced any losses in such accounts. Management believes it is not exposed to any significant credit risk related to cash. Cash equivalents include investments in a money market fund that are not federally insured.

4. Reinsurance Coverage

For 2013 and 2012, KLCIS purchased reinsurance coverage for the liability pool from one reinsurance carrier rated "A" (Excellent) by A.M. Best and Company. The policy is for specific coverage on claims $9,000,000 in excess of $1,000,000.

Reinsurance coverage for the property pool 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 specific excess of loss reinsurance for claims in excess of $350,000, the property pool also maintains aggregate reinsurance coverage. Policy limits vary based upon type and amount of insured risk. Reinsurance premiums are based upon a percentage of direct property pool premium revenue or total insured value.

Although the purchase of reinsurance coverage does not discharge KLCIS from it 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 KLCIS for accounting purposes to treat insured risks, to the extent of reinsurance coverage, as though they were risks for which KLCIS is not liable. However, KLCIS remains contingently liable in the event its reinsurers are unable to meet their contractual obligations.

Reinsurance premiums ceded were $3,795,688 and $3,549,212 for the years ended June 30, 2013 and 2012, respectively. Additional recoveries accrued on paid claims during 2013 and 2012 were $1,243,012 and $1,781,331, respectively. The liability for unpaid losses and loss adjustment expenses has been reduced to reflect reinsurance recoverables on policy case reserves and estimated recoverables on claims incurred but not reported by $2,681,150 and $1,270,227 in 2013 and 2012, respectively.

5. Related Party Transactions

The following entities are KLCIS related entities:

Kentucky League of Cities (KLC)
Kentucky League of Cities Insurance Agency (KLCIA)
Kentucky League of Cities Premium Finance Company (KLCPFC)
Kentucky League of Cities Unemployment Compensation Reimbursement Trust (KLCUCRT)
Kentucky League of Cities Workers Compensation Trust (KLCWCT)
Kentucky School Boards Insurance Trust Workers Compensation Fund (KSBITWCF)
Kentucky School Boards Insurance Trust Property and Liability Fund (KSBITPLF)

5. Related Party Transactions, continued

KLCIS was organized by KLC at the request of the state municipalities. KLC provides substantially all of KLCIS' operational, management and administrative services in exchange for an administrative fee based on allocated costs plus a percentage of earned premiums. Total administrative fees under the agreement amounted to $3,541,689 and $3,539,918 for the years ended June 30, 2013 and 2012, respectively.

KLCIS participates in a marketing agreement with Kentucky League of Cities Insurance Agency (the Agency) which provides that KLCIS pay a commission for member accounts marketed or serviced by the Agency. Commission expense under the agreement was $783,500 and $759,579 for the years ended June 30, 2013 and 2012, respectively.

KLCIS' directors' and officers' insurance provides coverage for KLC board members. Also, certain trustees of KLCIS are directors for KLC. KLC serves as Administrator of KLCIS.

KLCIS reports amounts as being due from or due to related parties. Related party receivables and payables included within KLCIS' statements of net assets consist of the following as of June 30:

	2013	2012
KLC accounts (payable) receivable	$ (292,712)	$ 227,711
KLCUCRT accounts receivable	-	997,385
KLCWCT accounts receivable	330,051	4,584,260
KLCPFC accounts (payable) receivable	(12,357)	330,875
KLCIA accounts payable	(51,166)	(271,304)
Total due (to) from related entities	$ (26,184)	$ 5,868,927

6. 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, 2013 and 2012 is summarized as follows:

	Liability Pool		Property Pool	
	2013	2012	**2013**	2012
Net unpaid losses and loss adjustment expenses, beginning of year	**$ 25,619,258**	$ 26,294,170	**$ 1,052,730**	$ 1,105,335
Incurred losses and loss adjustment expenses:				
Provision for insured events of the current year	**9,319,780**	10,859,459	**1,100,694**	1,617,805
(Decrease) increase in provision for insured events of prior years	**(2,632,015)**	(3,404,211)	**627,683**	934,398
Total incurred losses and loss adjustment expenses	**6,687,765**	7,455,248	**1,728,377**	2,552,203
Payments:				
Losses and loss adjustment expenses attributable to insured events of the current year	**2,100,226**	2,267,470	**600,248**	1,040,802
Losses and loss adjustment expenses attributable to insured events of prior years	**5,077,666**	5,862,690	**1,120,721**	1,564,006
Total payments	**7,177,892**	8,130,160	**1,720,969**	2,604,808
Net unpaid losses and loss adjustment expenses, end of year	**$ 25,129,131**	$ 25,619,258	**$ 1,060,138**	$ 1,052,730

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

7. Commitments and Contingencies

KLCIS is the guarantor for an irrevocable standing letter of credit with a bank for a related party. The letter of credit permitted borrowings of $3.3 million as of June 30, 2013. As of June 30, 2013 and 2012, no amounts were outstanding under the letter of credit. The investments of KLCIS are used as collateral for the letter of credit.

DEAN DORTON
DEAN DORTON ALLEN FORD, PLLC

Independent Auditors' 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*

Board of Trustees
Kentucky League of Cities Insurance Services Association
Lexington, Kentucky

We have audited, in accordance with the 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, the financial statements of Kentucky League of Cities Insurance Services Association (KLCIS) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise KLCIS' basic financial statements, and have issued our report thereon dated November 6, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered KLCIS' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of KLCIS' internal control.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether KLCIS' financial statements are free from material misstatement, 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of KLCIS' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dean Dorton Allen Ford, PLLC

November 6, 2013
Lexington, Kentucky

Supplementary Information

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Statements of Net Position Information

June 30, 2013 and 2012

	2013			2012		
Assets	Liability Pool	Property Pool	Total	Liability Pool	Property Pool	Total
Investment securities, at fair value	$ 35,652,693	$ -	$ 35,652,693	$ 29,131,857	$ -	$ 29,131,857
Cash and cash equivalents	6,090,817	-	6,090,817	2,457,396	-	2,457,396
Accounts receivable, net	127,983	1,720	129,703	117,989	42,681	160,670
Reinsurance receivable	389,884	1,356,710	1,746,594	553,124	1,621,789	2,174,913
Receivable from related entities	-	-	-	2,762,653	3,106,274	5,868,927
Accrued investment income	153,484	-	153,484	149,170	-	149,170
Prepaid expenses	142,211	107,290	249,501	168,072	106,778	274,850
Membership in NLC Mutual Insurance Company	620,037	-	620,037	620,037	-	620,037
Property and equipment, net	238,115	36,368	274,483	237,936	26,270	264,206
Total assets	43,415,224	1,502,088	44,917,312	36,198,234	4,903,792	41,102,026
Liabilities						
Unpaid losses and loss adjustment expenses:						
Reported claims	13,818,054	573,217	14,391,271	12,820,811	697,999	13,518,810
Incurred but not reported claims	10,415,955	444,289	10,860,244	11,970,097	342,739	12,312,836
Unallocated loss adjustment expenses	895,122	42,632	937,754	828,350	11,992	840,342
Total unpaid loss and loss adjustment expenses	25,129,131	1,060,138	26,189,269	25,619,258	1,052,730	26,671,988
Accounts payable	240,051	54,226	294,277	121,851	55,986	177,837
Payable to related entities	3,075,338	(3,049,154)	26,184	-	-	-
Advance premiums	1,698,633	750,679	2,449,312	2,239,614	952,913	3,192,527
Total liabilities	30,143,153	(1,184,111)	28,959,042	27,980,723	2,061,629	30,042,352
Net Position						
Net position	$ 13,272,071	$ 2,686,199	$ 15,958,270	$ 8,217,511	$ 2,842,163	$ 11,059,674

See report of independent auditors.

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Statements of Revenues, Expenses and Changes in Net Position Information

Years ended June 30, 2013 and 2012

	2013			2012		
	Liability Pool	Property Pool	Total	Liability Pool	Property Pool	Total
Operating revenue:						
Net premiums earned	$ 16,898,971	$ 3,820,808	$ 20,719,779	$ 15,515,790	$ 3,412,302	$ 18,928,092
Operating expenses:						
Losses and loss adjustment expenses	6,687,765	1,728,377	8,416,142	7,455,248	2,552,203	10,007,451
Commission expense	1,841,738	1,026,057	2,867,795	1,693,791	939,809	2,633,600
Claims administration expense	904,951	177,287	1,082,238	929,089	131,355	1,060,444
Loss prevention expenses	291,082	3,282	294,364	223,531	-	223,531
Professional fees	297,787	165,692	463,479	104,243	146,740	250,983
Administrative fees, related entity	2,676,331	865,358	3,541,689	2,681,417	858,501	3,539,918
Other expenses	298,534	44,597	343,131	252,903	59,786	312,689
Total operating expenses	12,998,188	4,010,650	17,008,838	13,340,222	4,688,394	18,028,616
Operating income (loss)	3,900,783	(189,842)	3,710,941	2,175,568	(1,276,092)	899,476
Nonoperating revenue:						
Interest and investment revenue	1,112,909	26,226	1,139,135	727,762	58,124	785,886
Other income	40,868	7,652	48,520	33,934	1,568	35,502
Total nonoperating revenue	1,153,777	33,878	1,187,655	761,696	59,692	821,388
Change in net position	5,054,560	(155,964)	4,898,596	2,937,264	(1,216,400)	1,720,864
Net position, beginning of year	8,217,511	2,842,163	11,059,674	5,280,247	4,058,563	9,338,810
Net position, end of year	$ 13,272,071	$ 2,686,199	$ 15,958,270	$ 8,217,511	$ 2,842,163	$ 11,059,674

See report of independent auditors.

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Claims Development Information (*Unaudited*)

Years ended June 30, 2004 through 2013

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 data for successive policy years.

		Liability Pool Fiscal and Policy Year Ended									
		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
(1)	Earned premium revenue and net investment income:										
	Earned	$ 16,973,665	$ 19,765,935	$ 20,200,768	$ 22,961,726	$ 21,786,096	$ 18,807,426	$ 20,240,270	$ 19,402,472	$ 17,728,986	$ 19,521,227
	Ceded	3,471,917	3,307,028	3,736,606	4,376,166	4,565,945	4,122,608	4,067,453	2,348,135	1,485,434	1,509,347
	Net earned	13,501,748	16,458,907	16,464,162	18,585,560	17,220,151	14,684,818	16,172,817	17,054,337	16,243,552	18,011,880
(2)	Unallocated expenses	3,218,607	4,416,830	4,988,671	5,866,615	6,426,405	6,251,928	6,217,737	5,706,601	5,884,973	6,310,423
(3)	Estimated incurred claims and expenses, end of policy year:										
	Incurred	8,604,998	8,588,936	8,748,208	10,534,883	11,689,774	11,768,385	10,948,096	13,486,832	4,527,857	3,935,737
	Ceded	201,324	74,476	-	-	-	-	-	-	-	-
	Net incurred	8,403,674	8,514,460	8,748,208	10,534,883	11,689,774	11,768,385	10,948,096	13,486,832	4,527,857	3,935,737
(4)	Net paid (cumulative) as of:										
	End of policy year	1,997,396	1,769,419	1,872,350	2,048,829	2,413,020	2,193,272	2,073,659	2,327,494	2,267,470	2,100,226
	One year later	3,596,628	2,904,133	4,269,039	3,953,727	4,589,949	4,449,503	3,934,091	4,078,942	3,323,205	
	Two years later	4,936,773	4,297,486	6,264,229	5,408,436	6,925,392	6,777,006	5,184,363	5,668,523		
	Three years later	5,786,878	7,022,278	7,361,262	6,929,353	8,482,193	7,944,206	6,318,178			
	Four years later	6,932,750	8,336,391	8,651,218	7,595,630	9,471,504	8,312,890				
	Five years later	7,977,979	8,471,800	8,763,106	7,704,053	9,646,816					
	Six years later	8,059,738	8,658,858	9,007,734	7,829,248						
	Seven years later	8,118,286	8,735,381	9,119,744							
	Eight years later	8,121,637	8,746,493								
	Nine years later	8,124,248									
(5)	Reestimated ceded claims and expenses	-	855,518	579,834	-	-	-	-	-	-	-
(6)	Reestimated net incurred claims and expenses:										
	End of policy year	8,403,674	8,514,460	8,748,208	10,534,883	11,689,774	11,768,385	10,948,096	13,486,832	4,527,857	3,935,737
	One year later	7,999,959	7,992,200	9,192,945	9,306,548	11,940,064	11,603,798	10,904,727	8,622,793	6,600,636	
	Two years later	7,721,014	8,265,582	9,704,319	9,453,663	12,129,275	10,604,964	8,276,099	9,941,020		
	Three years later	8,136,219	9,005,291	9,417,554	8,999,121	11,189,006	9,050,356	8,447,681			
	Four years later	8,425,837	8,989,550	9,361,716	8,464,396	10,053,370	9,200,913				
	Five years later	8,567,057	9,033,362	9,218,997	7,928,223	10,128,669					
	Six years later	8,327,301	8,973,507	9,212,745	8,156,878						
	Seven years later	8,246,638	8,795,656	9,282,259							
	Either years later	8,201,103	8,762,127								
	Nine years later	8,098,954									
(7)	Increase (decrease) in estimated net incurred claims and expenses from the end of the policy year	(304,720)	247,667	534,051	(2,378,005)	(1,561,105)	(2,567,472)	(2,500,415)	(3,545,812)	2,072,779	-

See report of independent auditors.

KENTUCKY LEAGUE OF CITIES INSURANCE SERVICES ASSOCIATION

Claims Development Information (*Unaudited*)

Years ended June 30, 2004 through 2013

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 data for successive policy years.

		Property Pool									
		Fiscal and Policy Year Ended									
		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
(1)	Earned premium revenue and net investment income:										
	Earned	$ 4,767,188	$ 5,301,624	$ 5,722,978	$ 6,719,752	$ 6,811,806	$ 6,365,897	$ 6,920,352	$ 6,136,090	$ 5,534,204	$ 6,133,375
	Ceded	1,823,338	1,764,738	1,873,329	2,407,379	1,546,039	1,292,868	1,646,914	1,724,440	2,063,778	2,286,341
	Net earned	2,943,850	3,536,886	3,849,649	4,312,373	5,265,767	5,073,029	5,273,438	4,411,650	3,470,426	3,847,034
(2)	Unallocated expenses	1,576,757	1,362,933	1,648,508	1,988,126	2,324,599	2,561,715	2,856,688	2,456,818	2,136,191	2,282,273
(3)	Estimated incurred claims and expenses, end of policy year:										
	Incurred	930,403	2,400,425	2,155,018	1,768,183	2,260,910	2,116,384	3,942,432	2,386,715	1,318,409	800,317
	Ceded	-	801,118	352,000	505,000	507,046	735,645	2,186,714	315,968	-	-
	Net incurred	930,403	1,599,307	1,803,018	1,263,183	1,753,864	1,380,739	1,755,718	2,070,747	1,318,409	800,317
(4)	Net paid (cumulative) as of:										
	End of policy year	311,952	1,123,046	1,095,824	878,190	1,116,949	569,117	1,096,057	842,088	1,040,802	600,248
	One year later	918,602	1,564,130	1,708,538	1,154,813	1,492,362	2,031,162	1,690,691	2,041,327	1,659,994	
	Two years later	918,602	1,609,723	1,713,367	1,304,994	1,607,098	2,066,094	1,938,334	2,207,441		
	Three years later	935,017	1,609,723	1,713,586	1,304,994	1,686,563	2,113,937	1,993,774			
	Four years later	935,017	1,609,723	1,713,586	1,305,082	1,686,125	2,113,809				
	Five years later	921,691	1,609,724	1,713,674	1,305,038	1,686,125					
	Six years later	921,691	1,611,815	1,712,970	1,305,078						
	Seven years later	921,691	1,611,815	1,712,216							
	Eight years later	921,991	1,611,815								
	Nine years later	921,989									
(5)	Reestimated ceded claims and expenses	13,576	1,249,869	537,724	326,308	478,414	735,645	-	13,218	-	-
(6)	Reestimated net incurred claims and expenses:										
	End of policy year	930,403	1,803,018	1,263,183	1,753,864	1,380,739	1,755,718	2,070,747	1,318,409	1,318,409	800,317
	One year later	938,960	1,635,969	1,718,492	1,264,938	1,513,503	2,243,833	1,745,691	2,406,715	2,030,141	
	Two years later	918,602	1,609,723	1,716,736	1,312,943	1,607,098	2,091,094	1,948,334	2,210,441		
	Three years later	935,017	1,609,723	1,713,586	1,304,994	1,686,563	2,113,937	1,993,774			
	Four years later	935,017	1,609,723	1,713,586	1,305,082	1,686,125	2,113,809				
	Five years later	921,741	1,609,724	1,713,674	1,305,038	1,686,125					
	Six years later	921,691	1,611,815	1,712,970	1,305,078						
	Seven years later	921,691	1,611,815	1,712,216							
	Either years later	921,991	1,611,815								
	Nine years later	921,989									
(7)	Increase (decrease) in estimated net incurred claims and expenses from the end of the policy year	(8,414)	12,508	(90,802)	41,895	(67,739)	733,070	238,056	139,694	711,732	-

See report of independent auditors.