



Financial Statements and Supplementary Information

for

**KENTUCKY LEAGUE OF CITIES
WORKERS' COMPENSATION TRUST**

Years Ended June 30, 2021 and 2020
with Report of Independent Auditors

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Report of Independent Auditors

Board of Trustees`
Kentucky League of Cities Workers' Compensation Trust
Lexington, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Kentucky League of Cities Workers' Compensation Trust (the Trust) which comprise the statements of net position as of June 30, 2021 and 2020, 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 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 net position of Kentucky League of Cities Workers' Compensation Trust as of June 30, 2021 and 2020, the changes in its net 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 3 - 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 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

The supplementary information on page 22 is presented for purposes of additional analysis and is not a required part of the basic 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 basic financial statements. The supplementary information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion on the supplementary information referred to above nor do we provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 19, 2021 on our consideration of the Trust's 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 solely 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 effectiveness of the Trust's 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 the Trust's internal control over financial reporting and compliance.

Dean Dotson Allen Ford, PLLC

Lexington, Kentucky
October 19, 2021

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Management's Discussion and Analysis (*Unaudited*)

Our discussion and analysis of the Kentucky League of Cities Workers' Compensation Trust (the Trust) provides an overview of the Trust's financial activity for the fiscal year ended June 30, 2021. It should be read in conjunction with the financial statements, which begin on page 6.

Using this Annual Report

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

Statements of Net Position

Table 1 shows all the assets and liabilities of the Trust and is presented on the accrual basis. Total net position increased \$8,137,366 for the current fiscal year, resulting in an overall increase in net position of \$23,368,292 since 2015. This growth in surplus better positions the Trust in the event of possible adverse claims development while at the same time providing more rate stability for our members.

Table 1
Net Position

	<u>2021</u>	<u>2020</u>
Cash and investments	\$ 65,975,759	\$ 58,355,026
Capital and other assets	<u>2,380,651</u>	<u>2,676,700</u>
Total assets	68,356,410	61,031,726
Unpaid losses and loss adjustment expenses	38,333,316	37,218,618
Other liabilities	<u>1,709,590</u>	<u>3,636,970</u>
Total liabilities	<u>40,042,906</u>	40,855,588
Net position	\$ <u>28,313,504</u>	\$ <u>20,176,138</u>

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Management's Discussion and Analysis (*Unaudited*), continued

Statement of Revenues, Expenses and Changes in Net Position

Table 2 shows the revenues and expenses of the Trust and is also presented on the accrual basis. Net earned premium revenue decreased \$268,034, or 2.1%, from the prior fiscal year. Investment related revenues and other revenues increased \$6,022,675. Losses and loss adjustment expenses increased \$3,087,347, primarily to a increase in claim severity in the current year. Prior year results also developed at lower than expected amounts (see Footnote 7 for details). The Trust continues to focus efforts on reducing medical costs and reducing the number of new claims as discussed in the following paragraph.

Table 2
Change in Net Position

Year ended June 30,	<u>2021</u>	<u>2020</u>
Net premiums earned	\$ 12,356,279	\$ 12,624,313
Investment and other revenue	<u>8,200,221</u>	<u>2,177,546</u>
Total revenue	20,556,500	14,801,859
Losses and loss adjustment expenses	8,544,731	5,457,384
General administrative expenses	<u>3,874,403</u>	<u>4,215,091</u>
Total expenses and losses	<u>12,419,134</u>	<u>9,672,475</u>
Change in net position	\$ <u>8,137,366</u>	\$ <u>5,129,384</u>

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Management's Discussion and Analysis (*Unaudited*), continued

Description of Current and Expected Conditions

As of December 15, 2013, the Trust started using internal staff to adjust workers' compensation claims. The Trust still utilizes the services of a third-party administrator to adjust post award claims. There has been a significant reduction in the number of newly reported litigated claims since bringing claims handling in house. Loss Control visits continue to focus on members with higher frequency of losses and include quarterly follow up visits to assist members in reducing claims. All prior year claims are now reserved at a projected level sufficient to cover all expected future benefit obligations. This change from projecting ten years of future medical costs to lifetime estimates has been implemented over the past several years. All claims have been reviewed and revised based upon current information.

A third party telephonic nurse case manager has been engaged to compliment the current use of field case managers and to further assist in controlling escalating medical costs. Also, a managed care organization was implemented effective July 1, 2016. Under this system, the Company Nurse has become mandatory for all members to report claims. A nurse triages the injury on the front end to help direct the employee to the most appropriate level of care. The Trust also contracted with a third party to provide in-office nurse case management for routine injuries and field nurse case management for serious injuries. In addition, an approved Preferred Provider Network of physicians was developed for the treatment of work-related injuries. The Trust's efforts continue to focus on reducing reported claims, efficiently closing claims, and managing medical costs. These changes have been crucial to the improved results for recent years. Management anticipates that these changes will continue to strengthen and improve the long-term results of the Trust's program.

Contacting the Organization's Financial Management

This financial report is designed to provide a general overview of 2021 operations and to show the Trust's accountability to its members. If you have any questions about this report or need additional information, contact the Kentucky League of Cities office at 100 East Vine Street, Suite 800, Lexington, KY 40507.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Net Position

June 30, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Assets		
Investment securities, at fair value	\$ 51,928,925	\$ 47,752,559
Cash and cash equivalents	14,046,834	10,602,467
Accounts receivable, net of allowance for doubtful accounts of \$28,000 and \$21,707 for 2021 and 2020, respectively	1,765	48,952
Excess insurance recoverable	1,107,436	1,402,484
Accrued investment income	220,276	244,196
Prepaid expenses	24,969	24,366
Membership in NLC Mutual Insurance Company	<u>1,026,205</u>	<u>956,702</u>
Total assets	68,356,410	61,031,726
Liabilities		
Unpaid losses and loss adjustment expenses:		
Reported claims	31,724,168	30,761,593
Incurred but not reported claims	5,546,716	5,410,966
Unallocated loss adjustment expenses	<u>1,062,432</u>	<u>1,046,059</u>
Total unpaid losses and loss adjustment expenses	38,333,316	37,218,618
Accounts payable	599,507	478,787
Payable to related entities, net	171,251	1,934,035
Advance premiums	<u>938,832</u>	<u>1,224,148</u>
Total liabilities	<u>40,042,906</u>	<u>40,855,588</u>
Net Position		
Net position	<u>\$ 28,313,504</u>	<u>\$ 20,176,138</u>

See accompanying notes.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Revenues, Expenses and Changes in Net Position

Years ended June 30, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Operating revenue:		
Net premiums earned	\$ 12,356,279	\$ 12,624,313
Operating expenses:		
Losses and loss adjustment expenses	8,544,731	5,457,384
Commission expense	1,123,212	1,169,658
Claims administration expense	267,677	483,171
Loss prevention expenses	129,349	166,554
Professional fees	205,192	159,458
Administrative fees, related entity	2,001,957	2,057,309
Other expenses	<u>147,016</u>	<u>178,941</u>
Total operating expenses	<u>12,419,134</u>	<u>9,672,475</u>
Operating (loss) income	(62,855)	2,951,838
Nonoperating revenue:		
Interest and investment revenue	8,102,208	2,033,620
Other income	<u>98,013</u>	<u>143,926</u>
Total nonoperating revenue	<u>8,200,221</u>	<u>2,177,546</u>
Change in net position	8,137,366	5,129,384
Net position, beginning of year	<u>20,176,138</u>	<u>15,046,754</u>
Net position, end of year	<u>\$ 28,313,504</u>	<u>\$ 20,176,138</u>

See accompanying notes.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Statements of Cash Flows

Years ended June 30, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Cash flows from operating activities:		
Premiums collected	\$ 12,111,857	\$ 12,563,338
Losses and loss adjustment expenses paid	(7,430,033)	(8,385,000)
Underwriting and administrative expenses paid	(4,989,933)	(3,827,611)
Other payments	<u>(197,286)</u>	<u>(258,002)</u>
Net cash (used in) provided by operating activities	(505,395)	92,725
Cash flows from investing activities:		
Purchases of investments	(22,004,733)	(20,766,662)
Proceeds from maturity of investments	2,252,332	1,496,750
Proceeds from sale of investments	18,757,646	7,377,574
Interest, dividends and gains received	<u>4,944,517</u>	<u>1,586,209</u>
Net cash provided by (used in) investing activities	<u>3,949,762</u>	<u>(10,306,129)</u>
Net increase (decrease) in cash and cash equivalents	3,444,367	(10,213,404)
Cash and cash equivalents, beginning of year	<u>10,602,467</u>	<u>20,815,871</u>
Cash and cash equivalents, end of year	<u>\$ 14,046,834</u>	<u>\$ 10,602,467</u>
Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:		
Operating (loss) income	\$ (62,855)	\$ 2,951,838
Adjustments:		
Provision for doubtful accounts	6,293	20,707
Other income	98,013	143,926
Increase (decrease) in cash due to changes in:		
Accounts receivable	40,894	(17,043)
Excess insurance recoverable	295,048	(596,989)
Prepaid expenses	(603)	(16,732)
Membership in NLC Mutual Insurance Company	(69,503)	(39,514)
Unpaid losses and loss adjustment expenses	1,114,698	(2,927,616)
Accounts payable	120,720	(27,988)
Payable to related entities, net	(1,762,784)	646,068
Advance premiums	<u>(285,316)</u>	<u>(43,932)</u>
Net cash (used in) provided by operating activities	<u>\$ (505,395)</u>	<u>\$ 92,725</u>

See accompanying notes and independent auditors' report.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements

1. Description of Organization

Effective July 1, 1978, the Kentucky Association of Counties (KACo) and the Kentucky League of Cities, Inc. (KLC) formed the KACo-KLC Self-Insurance (KACo-KLC Fund). The KACo-KLC Fund was formed as a joint city/county group workers' compensation self-insurance fund.

Effective June 30, 1993, the KACo-KLC Fund ceased writing new business. In July 1, 1993, both KACo and KLC formed new, separate group workers' compensation self-insurance funds for their respective members. Kentucky League of Cities Workers' Compensation Trust (the Trust) was established under the authorization of the Kentucky Interlocal Cooperation Act of the Kentucky Revised Statutes. It is an unincorporated, nonprofit trust voluntarily established by the participating cities, urban-county governments and related public agencies and political subdivisions within the Commonwealth of Kentucky.

The Trust has received a Certificate of Filing from the Department of Insurance of the Commonwealth of Kentucky (the Department) but is exempt from most statutory requirements that commercial insurers must follow. The Trust's general objectives are to formulate, develop and administer, on behalf of the member political subdivisions, a workers' compensation insurance program and to obtain lower costs for that coverage. All coverages are written on an occurrence basis. Participation in the Trust included 377 and 373 members as of June 30, 2021 and 2020, respectively.

On July 1, 1995 the assets, liabilities, and responsibility for effective claims administration stemming from existing open claims obligations of the KACo-KLC Fund were divided proportionally between the KACo Fund and the Trust. The Trust's portion of the KACo-KLC Fund is known as the Prior Workers' Compensation Fund, which is now a component of the Trust.

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

Legal/Regulatory Risk

Legal/regulatory risk is the risk that changes in the legal or regulatory environment in which an insurer operates will occur and create additional losses or expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits or new legal theories may create costs for the insurer beyond those currently recorded in the financial statements. The Trust is exposed to this risk by writing all of its business in Kentucky, thus increasing its exposure to a single jurisdiction. This risk is reduced by underwriting and loss adjusting practices that identify and minimize the adverse impact of this risk.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements

1. Description of Organization, continued

Credit Risk

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

Interest Rate Risk

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

2. Summary of Significant Accounting Policies

Basis of Accounting

The Trust uses the accrual basis of accounting. Under this method, revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred.

The Trust presents its financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. As a proprietary activity, the 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 Trust follows GASB pronouncements and all Financial Accounting Standards Board and predecessor boards' pronouncements except those that conflict with or contradict GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

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

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Use of Estimates, continued

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 the Trust 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.

Cash and Cash Equivalents

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

Accounts Receivable

In accordance with GAAP in the insurance industry, the Trust 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.

Membership in NLC Mutual Insurance Company

The membership in NLC Mutual Insurance Company is carried at cost plus allocated surplus as allowed by the Department.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

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. All policy years coincide with the Trust's fiscal year.

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 excess insurance 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 2021 and 2020. Discounting reduced the liability by \$7,568,174 and \$8,607,795 as of June 30, 2021 and 2020, respectively. The effect of discounting on the provision for losses and loss adjustment expenses was an increase of \$1,039,621 and \$31,341 in 2021 and 2020, respectively.

Excess Insurance

Excess insurance 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 excess insurance contracts. Premiums, losses, and loss adjustment expenses are reported net of excess insurance amounts. The Trust evaluates the financial condition of its excess carriers to minimize its exposure to significant losses from reinsurer insolvencies. The Trust holds funds and collateral as security under excess insurance agreements in the form of letters of credit for any excess carriers not subject to the regulation of the Kentucky Commissioner of Insurance. In the opinion of management, all amounts due from excess insurance carriers at June 30, 2021 and 2020 are recoverable.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Net Position

The Board of Trustees may, at its discretion, refund to members the savings, if any, resulting from operations of the Trust in the form of dividends or reduced premiums. The amount of any future dividends or reductions in premiums is dependent on the Trust's ultimate liability for claims incurred and, accordingly, the amount may differ from the net position. No refunds were issued during 2021 or 2020.

In the event of adverse loss experience, the Trust 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. Capital contributions are refundable only at the discretion of the Board of Trustees. There have been no assessments levied since the inception of the Trust.

Federal Income Taxes

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

COVID-19

In March 2020, the World Health Organization declared the coronavirus (COVID-19) outbreak to be a pandemic. COVID-19 continues to spread across the globe and is impacting worldwide economic activity and financial markets. The Trust is closely monitoring the impact of the COVID-19 pandemic on all aspects of its operations. The continued spread of the disease represents a significant risk that operations could be disrupted in the near future. The extent to which COVID-19 impacts the Trust will depend on future developments, which are highly uncertain and cannot be predicted.

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through October 19, 2021, the date that the financial statements were available to be issued.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

3. Deposits and Investments

The composition of the Trust's investment portfolio must meet certain criteria as set forth in the Kentucky Administrative Regulations. Investments held by the Trust as of June 30, 2021 and 2020 are as follows:

	<u>2021</u>	<u>2020</u>
Deposits and investments classified as cash and cash equivalents:		
Cash and cash equivalents	\$ 1,657,725	\$ 3,112,558
Money market mutual funds and uninvested cash	<u>12,389,109</u>	<u>7,489,909</u>
	14,046,834	10,602,467
Investments classified as investment securities:		
Certificates of deposit	7,399,590	9,031,378
Corporate bonds	2,895,640	2,129,253
Municipal bonds	15,999,458	14,084,157
U.S. government agency obligations	2,305,633	2,800,319
Equity securities	12,758,942	11,978,827
Equity mutual funds	10,323,329	7,502,322
Bond mutual funds	<u>246,333</u>	<u>226,303</u>
	<u>51,928,925</u>	<u>47,752,559</u>
Total deposits and investments	<u>\$ 65,975,759</u>	<u>\$58,355,026</u>

As of June 30, 2021, the Trust had the following investment maturities in years:

	<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More than 10</u>
Certificates of deposit	\$ 1,754,829	\$ 5,644,761	\$ -	\$ -
Corporate bonds	-	2,895,640	-	-
Municipal bonds	385,647	11,159,351	2,699,460	1,755,000
U.S. government agency obligations	<u>505,640</u>	<u>514,590</u>	<u>498,875</u>	<u>786,528</u>
Total maturities	<u>\$ 2,646,116</u>	<u>\$ 20,214,342</u>	<u>\$ 3,198,335</u>	<u>\$ 2,541,528</u>

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

3. Deposits and Investments, continued

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

	<u>2021</u>	<u>2020</u>
Interest and dividend income	\$ 1,235,641	\$ 1,391,792
Net realized gains on sales of securities	3,684,956	206,352
Unrealized gains on securities, net	<u>3,181,611</u>	<u>435,476</u>
	<u>\$ 8,102,208</u>	<u>\$ 2,033,620</u>

Fair Value

Investments, including derivative instruments that are not hedging derivatives, are measured at fair value on a recurring basis. Recurring fair value measurements are those that GAAP requires or permits in the statement of net position at the end of each reporting period. Fair value measurements are categorized based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quotes prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

Certificates of deposit are valued at cost which approximates fair value. All of the Trust's other investments are actively traded and categorized as Level 1 investments in the fair value hierarchy.

Credit Risk

Pursuant to state law, no more that 20% of net position may be invested in medium and lower grade investments; no more than 10% of net position 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 net position; investments with a rating of 6 from a NRSRO cannot exceed 1% of net position. The Trust's 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 the Trust's 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 net position. The Trust's policy further states that total medium grade holdings tied to a single source shall be limited to 1% of total assets. State law and the Trust's policy both require that no more than 3% of net position shall be invested in any single asset or, for asset backed securities, any single pool of assets.

State law and the Trust investment guidelines assert that corporate bonds are allowable if issued, assumed, or guaranteed by a solvent institution created and existing under the laws of the United States of America. They also state that corporate bond investments shall not exceed 25% of the total market value of the portfolio at the time of purchase and that the bond has a minimum rating of A.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

3. Deposits and Investments, continued

Credit Risk, continued

State law and the Trust investment guidelines assert that no individual equity holding shall comprise greater than 10% of the equity portion of the portfolio at the time of purchase. Both also state that an investment in an individual holding shall not represent at the time of purchase more than 5% of the market value of the holding. Furthermore, both state 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 held with registered investment advisors licensed by the Securities Exchange Commission and the 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.

With respect to cash and statute defined bonds, both sets of guidelines state that, of the total investments held, no less than 50% of the total market value shall be held in cash, cash equivalents, and fixed income. Also, a minimum of 5% of the total investments shall be held in cash, cash equivalents or U.S. Treasuries and federal agency securities with a 1 year or less maturity. The Trust may also invest surplus funds or reserves not needed for current obligations in the following: U.S. government bonds, Treasury notes and T-bills or other direct obligations guaranteed by the full faith and credit of the United States of America, tax exempt obligations issued by Kentucky or its agencies with a minimum Standard and Poor (S&P) rating of A.

Furthermore, the Trust may also invest in obligations issued by a country, district, municipality or other legal authority within Kentucky with a minimum S&P rating of AA. Investments may also be made in investment share accounts in a savings and loan institution in Kentucky which is insured by the Federal Deposit Insurance Corporation. Finally, the Trust may also invest in certificates of deposit if issued by a duly chartered commercial bank.

As of June 30, 2021, the Trust was invested in government agency, municipal and corporate bonds, common stocks and mutual funds. Of these bonds that were rated, all ranged in ratings from A to AAA. The Trust also invested in money market funds that were not rated.

Concentration of Credit Risk

As of June 30, 2021, the Trust held debt and equity securities in excess of 5% of the Trust's total investments issued by the following issuer: Kentucky Property and Building Commission (5.48%).

Custodial Credit Risk - Deposits

The Trust maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Trust 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.

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

4. Excess Insurance

For the years ended June 30, 2021 and 2020, respectively, the Trust purchased specific excess insurance coverage from Safety National, an "A+" (Superior) rated insurer rated by A.M. Best and Company, for the excess layer of insurance only to cover losses in excess of \$1,500,000 (retention). The Trust must self-insure up to the retention per occurrence limits. For 2021 and 2020, employer's liability loss limitations were \$4,000,000 (retention of \$1,500,000 plus \$2,500,000 of excess insurance). For the years ended June 30, 2021 and 2020, respectively, the Trust purchased specific excess insurance coverage from NLC Mutual Insurance Company for the excess layer of insurance only to cover 50% of \$500,000 in loss in excess of \$1,000,000 (retention). The Trust must self-insure up to retention limits per occurrence.

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

Excess insurance premiums ceded for the years ended June 30, 2021 and 2020 were \$1,085,175 and \$1,116,392, respectively. Additional recoveries accrued on paid claims during 2021 and 2020 were \$534,287 and \$2,455,214, respectively. The liability for unpaid losses and loss adjustment expenses has been reduced to reflect excess insurance recoverables on policy case reserves and estimated recoverables on claims incurred but not reported by \$17,419,083 and \$19,109,019 in 2021 and 2020, respectively.

5. Security Deposit

To satisfy requirements of the Department, the Trust maintains a security deposit account held under safekeeping with a bank in the amount of approximately \$4.5 million as of June 30, 2021.

6. Related Party Transactions

The following are related entities of the Trust:

- Kentucky Bond Corporation (KBC)
- Kentucky Bond Development Corporation (KBDC)
- Kentucky League of Cities (KLC)
- Kentucky League of Cities Funding Trust (KLCFT)
- Kentucky League of Cities Insurance Agency (KLCIA)
- Kentucky League of Cities Insurance Services Association (KLCIS)
- Kentucky League of Cities Investment Pool Plus (KLCIPP)
- Kentucky League of Cities Premium Finance Company (KLCPPFC)
- Kentucky League of Cities Unemployment Compensation Reimbursement Trust (KLCUCRT)
- Kentucky Local Government Health Trust (KLGHT)

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

6. Related Party Transactions, continued

The Trust was organized by KLC at the request of the state municipalities. KLC provides substantially all of the Trust's 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 \$2,001,957 and \$2,057,309 for the years ended June 30, 2021 and 2020, respectively.

The Trust participates in a marketing agreement with KLCIA which provides that the Trust pay a commission for member accounts marketed or serviced by KLCIA. Commission expense under the agreement was \$290,313 and \$297,605 for the years ended June 30, 2021 and 2020, respectively.

The Trust's directors' and officers' insurance provides coverage for KLC board members. Also, certain trustees of the Trust are directors of KLC.

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

	<u>2021</u>	<u>2020</u>
KLC accounts payable	\$ (169,926)	\$ (132,797)
KLCUCRT accounts payable	(1,896)	-
KLCIS accounts payable	(321,588)	(1,803,938)
KLCIA accounts receivable	<u>322,159</u>	<u>2,700</u>
Net payable to related entities	<u>\$ (171,251)</u>	<u>\$ (1,934,035)</u>

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST

Notes to the Financial Statements, continued

7. 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, 2021 and 2020 is summarized as follows:

	<u>2021</u>	<u>2020</u>
Net unpaid losses and loss adjustment expenses, beginning of year	\$ 37,218,618	\$ 40,146,234
Incurred losses and loss adjustment expenses:		
Provision for insured events of the current year	9,931,000	8,640,000
Decrease in provision for insured events of prior years	<u>(1,386,269)</u>	<u>(3,182,616)</u>
Total incurred losses and loss adjustment expenses	8,544,731	5,457,384
Payments:		
Losses and loss adjustment expenses attributable to insured events of the current year	2,114,981	2,033,070
Losses and loss adjustment expenses attributable to insured events of prior years	<u>5,315,052</u>	<u>6,351,930</u>
Total payments	<u>7,430,033</u>	<u>8,385,000</u>
Net unpaid losses and loss adjustment expenses, end of year	<u>\$ 38,333,316</u>	<u>\$ 37,218,618</u>

A decrease in the provision for insured events of prior years signifies that the Trust expects lower than anticipated ultimate losses in the final disposition of claims.

**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***

Report of Independent Auditors

Board of Trustees
Kentucky League of Cities Workers' Compensation Trust
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 Workers' Compensation Trust (the Trust), which comprise the statement of net position as of June 30, 2021, the related statement of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 19, 2021.

Internal Control Over Financial Reporting

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

Board of Trustees
Kentucky League of Cities Workers' Compensation Trust
Report of Independent Auditors, continued

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Trust's 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 the Trust's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Trust's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dean Dotson Allen Ford, PLLC

Lexington, Kentucky
October 19, 2021

KENTUCKY LEAGUE OF CITIES WORKERS' COMPENSATION TRUST
Claims Development Information (Unaudited)
Years ended June 30, 2012 through 2021

The following table illustrates how the Trust's earned premium revenue (net of excess insurance) and investment income compare to related costs of loss (net of loss assumed by excess insurance carriers) and other expenses assumed by the Trust 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 excess insurance carriers, and net earned premium revenue and reported investment revenue. (2) This line shows each fiscal year's other operating costs of the Trust including overhead and claims expense not allocable to individual claims. (3) This line shows the Trust's gross incurred claims and allocated claims adjustment expenses, claims assumed by excess insurance carriers, 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 excess insurance carriers 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.

		Fiscal and Policy Year Ended									
		2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
(1)	Earned premium revenue and net investment income:										
	Earned	\$ 14,003,578	\$ 11,855,839	\$ 15,587,040	\$ 13,442,044	\$ 14,792,894	\$ 14,211,303	\$ 15,341,744	\$ 16,498,198	\$ 15,774,325	\$ 21,543,662
	Ceded	738,366	784,959	881,546	880,281	851,810	1,168,123	1,217,706	1,041,508	1,116,392	1,085,175
	Net earned	13,265,212	11,070,880	14,705,494	12,561,763	13,941,084	13,043,180	14,124,038	15,456,690	14,657,933	20,458,487
(2)	Unallocated expenses	3,675,218	4,027,265	4,113,508	3,311,946	3,180,640	3,158,843	3,237,164	3,399,535	3,857,208	3,727,388
(3)	Estimated incurred claims and expenses, end of policy year:										
	Incurred	8,396,000	8,870,000	11,157,746	13,307,585	10,285,000	9,782,000	10,024,000	10,518,000	8,640,000	9,931,000
	Ceded	-	-	237,746	551,585	-	-	-	-	-	-
	Net incurred	8,396,000	8,870,000	10,920,000	12,756,000	10,285,000	9,782,000	10,024,000	10,518,000	8,640,000	9,931,000
(4)	Net paid (cumulative) as of:										
	End of policy year	2,166,759	1,903,747	2,663,585	3,458,053	2,195,901	2,257,198	1,979,853	2,498,948	2,033,070	2,114,981
	One year later	4,210,478	4,142,789	5,318,318	6,577,293	4,287,792	4,743,216	4,125,253	4,460,588	3,944,415	
	Two years later	5,496,361	5,232,100	7,558,252	8,507,865	5,333,555	6,270,521	6,247,661	5,747,072		
	Three years later	6,056,594	6,061,691	8,966,855	9,305,850	5,703,226	7,047,369	6,709,011			
	Four years later	6,918,166	6,290,380	9,379,836	9,612,115	6,064,651	7,350,029				
	Five years later	7,137,799	6,437,849	9,638,012	9,755,346	6,354,627					
	Six years later	7,434,319	6,560,566	9,752,998	9,896,550						
	Seven years later	7,572,347	6,662,656	9,914,540							
	Eight years later	7,935,539	6,829,963								
	Nine years later	8,090,245									
(5)	Reestimated ceded claims and expenses	998,784	-	44,390	413,863	-	449,034	2,298,289	-	-	-
(6)	Reestimated net incurred claims and expenses:										
	End of policy year	8,396,000	8,870,000	10,920,000	12,756,000	10,285,000	9,782,000	10,024,000	10,518,000	8,640,000	9,931,000
	One year later	8,700,000	9,240,000	11,313,000	13,701,000	9,517,000	10,849,000	11,338,000	9,965,000	9,205,000	
	Two years later	9,390,000	10,188,000	12,343,000	13,643,000	9,099,000	10,345,000	11,333,000	9,248,000		
	Three years later	11,253,000	9,415,000	13,117,000	12,650,000	8,688,000	10,528,000	11,300,000			
	Four years later	10,425,000	8,793,000	12,443,000	11,893,000	8,397,000	10,099,000				
	Five years later	10,679,000	9,223,000	12,487,437	11,755,000	8,068,000					
	Six years later	10,933,086	9,033,983	12,121,294	11,566,000						
	Seven years later	10,705,504	8,991,642	12,334,784							
	Eight years later	9,975,912	8,796,853								
	Nine years later	9,936,967									
(7)	Increase (decrease) in estimated net incurred claims and expenses from the end of the policy year	1,540,967	(73,147)	1,414,784	(1,190,000)	(2,217,000)	317,000	1,276,000	(1,270,000)	565,000	-

See report of independent auditors.