KENTUCKY ASSOCIATION OF COUNTIES -
ALL LINES FUND

FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Years Ended June 30, 2013 and 2012

CONTENTS

DMLO
DEMING MALONE
LIVESAY & OSTROFF
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Kentucky Association of Counties - All Lines Fund
Frankfort, Kentucky

We have audited the accompanying financial statements of Kentucky Association of Counties – All Lines Fund, which comprise the balance sheets as of June 30, 2013 and 2012, and the related statements of revenues, expenses and changes in members' equity, 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.

Auditors' 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. Those standards require that we plan and perform the audits 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 auditors' 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.

9300 Shelbyville Road · Suite 1100 · Louisville, Kentucky 40222
Telephone 502.426.9660 · Fax 502.425.0883 · www.DMLO.com

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Association of Counties – All Lines Fund as of June 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deming, Malone, Livesay & Ostroff

Louisville, Kentucky
October 30, 2013

KENTUCKY ASSOCIATION OF COUNTIES - ALL LINES FUND

BALANCE SHEETS

June 30, 2013 and 2012

ASSETS	2013	2012
Cash and cash equivalents	$ 9,952,051	$ 10,916,122
Investments	48,579,535	48,927,535
Member premiums receivable	35,374,171	28,919,660
Accrued interest receivable	167,759	207,643
Other	264,660	272,419
Total assets	$ 94,338,176	$ 89,243,379

LIABILITIES AND MEMBERS' EQUITY		
Estimated liability for future claims, net of estimated recoveries:		
Reported claims	$	$
Claims incurred but not reported		
	41,459,000	44,525,000
Unallocated loss adjustment expenses	511,000	192,000
Deferred revenue	37,414,015	30,686,439
Accounts payable	333,151	246,266
Total liabilities	79,717,166	75,649,705
MEMBERS' EQUITY	14,621,010	13,593,674
Total liabilities and members' equity	$ 94,338,176	$ 89,243,379

See Notes to Financial Statements.

KENTUCKY ASSOCIATION OF COUNTIES -
ALL LINES FUND

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN MEMBERS' EQUITY

Years Ended June 30, 2013 and 2012

	2013	2012
REVENUES		
Member premiums	$ 30,667,550	$ 29,488,279
Investment income	1,362,180	1,610,210
Realized and unrealized loss on investments	(174,265)	(415,526)
Total revenues	31,855,465	30,682,963
EXPENSES		
Claims expense, net of recoveries		
Reinsurance premiums		
Administration and marketing		
Professional fees		
Management expense		
Total expenses	30,828,129	36,257,388
Excess of revenues (expenses)	1,027,336	(5,574,425)
Members' equity, beginning of year	13,593,674	19,168,099
Members' equity, end of year	$ 14,621,010	$ 13,593,674

See Notes to Financial Statements.

KENTUCKY ASSOCIATION OF COUNTIES - ALL LINES FUND

STATEMENTS OF CASH FLOWS
Years Ended June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from member premiums	$ 30,940,615	$ 29,127,104
Reinsurance and other recoveries collected	20,232,715	6,958,933
Cash paid to suppliers	(14,825,804)	(13,557,417)
Claims paid	(38,887,396)	(25,491,034)
Investment income received	1,402,064	1,634,352
Net cash used in operating activities	(1,137,806)	(1,328,062)
Cash flows from investing activities:		
Purchase of investments	(34,906,217)	(25,755,751)
Proceeds from sale of investments	35,079,952	29,458,814
Net cash provided by investing activities	173,735	3,703,063
Net (decrease) increase in cash and cash equivalents	(964,071)	2,375,001
Cash and cash equivalents at beginning of year	10,916,122	8,541,121
Cash and cash equivalents at end of year	$ 9,952,051	$ 10,916,122

See Notes to Financial Statements.

	2013	2012
RECONCILIATION OF EXCESS OF REVENUES (EXPENSES) TO NET CASH USED IN OPERATING ACTIVITIES		
Excess of revenues (expenses)	$ 1,027,336	$ (5,574,425)
Adjustments to reconcile excess of revenues (expenses) to net cash used in operating activities:		
Realized and unrealized loss on investments	174,265	415,526
Changes in assets and liabilities:		
Decrease (increase) in:		
Member premiums receivable	(6,454,511)	(1,723,975)
Accrued interest receivable	39,884	24,142
Other	7,759	15,442
Increase (decrease) in:		
Estimated liability for future claims	(3,066,000)	4,171,000
Unallocated loss adjustment expense	319,000	17,000
Deferred revenue	6,727,576	1,362,800
Accounts payable	86,885	(35,572)
Total adjustments	(2,165,142)	4,246,363
Net cash used in operating activities	$ (1,137,806)	$ (1,328,062)

See Notes to Financial Statements.

Note 1. Nature of Business and Summary of Significant Accounting Policies

Nature of business:

The Kentucky Association of Counties - All Lines Fund (Fund) is for the purpose of assisting its participants, as defined by KRS 65.230, to formulate, develop and administer a program of self-insurance or partial self-insurance for the Fund participants to obtain lower costs of various types of insurance coverage, provide excess insurance coverage for the participants, and develop a comprehensive safety program. The Fund arranges to provide necessary administrative and legal services sufficient to meet the participants' obligations under Kentucky Law. All funds or monies held by the Fund are the property of the public agencies or political subdivisions participating in the Fund, and the Fund shall be an instrumentality of the participating public agencies and only execute essential governmental functions. It is the intent of the participants in the Fund to create an entity with a pool and use funds contributed by the members against a stated liability or loss to the limits of the financial resources of the Fund as specifically outlined in coverage agreements provided to the various participants. The Fund operates solely for the mutual and exclusive benefit of its members as a non-profit entity. The Fund's participants consisted of 113 counties and 608 political subdivisions for 2013.

Summary of significant accounting policies:

This summary of significant accounting policies of the Fund is presented to assist in understanding the Fund's financial statements. The financial statements are representations of the Fund's management who is responsible for the integrity and objectivity of the financial statements. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the financial statements.

Method of accounting:

The financial statements of the Fund have been prepared on the accrual basis of accounting.

Cash and cash equivalents:

For purposes of the statement of cash flows, the Fund considers only cash and investments with an original maturity of three months or less to be cash and cash equivalents.

Investments:

The Fund records all investments at fair market value. Fair value is established based upon readily determinable market quotations for equity and debt securities.

The Fund has significant investments in mutual funds, common stocks, government securities, and corporate bonds held by Central Bank & Trust Company. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Because of the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the balance sheet.

Allowance for uncollectible accounts:

As of June 30, 2013 and 2012, substantially all of the member premiums receivable consist of advance billings on the next year's premiums and are also included in deferred revenue. Any member premiums receivable for the current or prior years are reviewed by management and evaluated for collectibility.

No provision for doubtful accounts has been made at June 30, 2013 and 2012, as management considers all amounts fully collectible.

Reinsurance:

The Fund uses reinsurance agreements to reduce its exposure to large losses on all types of insured events. Reinsurance permits recovery of a portion of losses from reinsurers, although it does not discharge the primary liability of the Fund as direct insurer of the risks reinsured. The Fund does not report reinsured risks as liabilities unless it is probable that those risks will not be covered by the reinsurer.

Revenue and expense recognition:

Member premiums revenue is recognized over the period to which the insurance coverage relates. Deferred revenue represents member premiums billed but not yet earned.

Fund expenses for reinsurance premiums, management and marketing fees and royalties are expensed ratably over the period of coverage.

Income taxes:

The Fund is exempt from income taxes under Section 115 of the Internal Revenue Code. However, income from certain activities not directly related to the Fund's tax-exempt purpose may be subject to taxation as unrelated business income.

As of June 30, 2013 and 2012, the Fund did not have any accrued interest or penalties related to income tax liabilities, and no interest or penalties have been charged to operations for the years then ended. Tax years still open under federal and state statute of limitations remain subject to review and change.

Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at 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.

The most significant estimate included in the financial statements is the estimated liability for future claims (see Note 5).

Legal, regulatory and geographic risk:

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

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

Subsequent events:

Subsequent events have been evaluated through October 30, 2013, which is the date the financial statements were available to be issued.

Note 2. Investments

Investments are carried at fair market value as determined based on quoted prices in active markets. Investments held in a trust fund at Central Bank & Trust Company at June 30, 2013 consisted of the following:

NOTES TO FINANCIAL STATEMENTS

	Face Value	Cost	Fair Market Value
Mortgage-Backed Securities:			
Federal National Mortgage Association	$15,500,000	$15,509,765	$14,955,195
Federal Home Loan Bank	8,500,000	8,527,939	8,334,060
Federal Farm Credit Banks	6,500,000	6,500,000	6,197,465
Federal Home Loan Mortgage	3,000,000	3,000,000	2,870,400
	33,500,000	33,537,704	32,357,120
Corporate bonds	5,235,000	5,278,964	5,448,458
Common stocks		6,646,983	8,714,068
Mutual funds		990,000	1,181,648
Municipal bonds		691,871	686,856
Other investments		170,024	191,385
Total investments		$47,315,546	$48,579,535

Investments held in trust funds at Central Bank & Trust Company and FSC Securities Corporation at June 30, 2012 consisted of the following:

	Face Value	Cost	Fair Market Value
Mortgage-Backed Securities:			
Federal Home Loan Bank	$ 7,400,000	$ 7,426,314	$ 7,556,960
Federal National Mortgage Association	3,000,000	3,097,250	3,108,563
Federal Farm Credit Banks	14,000,000	13,990,500	14,063,895
	24,400,000	24,514,064	24,729,418
Corporate bonds	6,095,000	6,137,128	6,392,388
Common stocks		6,478,001	7,330,307
Mutual funds		9,470,810	9,517,142
Municipal bonds		691,871	776,057
Other investments		170,024	182,223
Total investments		$47,461,898	$48,927,535

The aggregate annual maturities of the fair market value of investments at June 30, 2013, based upon stated maturity dates are as follows:

Due within one year	$ 727,355
Due after one year through five years	10,191,119
Due after five years through ten years	25,293,960
Due after ten years	2,280,000
Common stocks	8,714,068
Mutual funds	1,181,648
Other investments	191,385
	$48,579,535

Note 3. Fair Value Measurements

Accounting principles generally accepted in the United States of America establish a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described as follows:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Fund has the ability to access.

Level 2 – Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active or inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in methodologies used at June 30, 2013.

Common stock and mutual funds – valued at the unadjusted quoted market price as of the financial statement date.

Corporate bonds, municipal bonds, exchange traded funds and mortgage-backed securities – valued at the quoted market prices for similar assets.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Fund believes their valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables set forth, by level, within the fair value hierarchy, the Fund's assets at fair value as of June 30, 2013 and 2012:

	June 30, 2013		
	Level 1	Level 2	Total
Mortgage-backed securities		$32,357,120	$32,357,120
Corporate bonds		5,448,458	5,448,458
Common stocks:			
Basic materials	$1,242,146		1,242,146
Consumer goods	213,080		213,080
Financial	1,108,370		1,108,370
Healthcare	1,255,265		1,255,265
Industrial goods	1,167,303		1,167,303
Services	2,429,017		2,429,017
Technology	1,039,969		1,039,969
Utilities	258,918		258,918
Mutual funds:			
International fund	581,162		581,162
Mid cap fund	264,399		264,399
Small cap fund	336,087		336,087
Municipal bonds		686,856	686,856
Exchange traded fund		191,385	191,385
Total assets at fair value	$9,895,716	$38,683,819	$48,579,535

	June 30, 2012		
	Level 1	Level 2	Total
Mortgage-backed securities		$24,729,418	$24,729,418
Corporate bonds		6,392,388	6,392,388
Common stocks:			
Basic materials	$ 1,262,259		1,262,259
Consumer goods	404,901		404,901
Financial	773,298		773,298
Healthcare	768,657		768,657
Industrial goods	1,244,169		1,244,169
Services	1,593,241		1,593,241
Technology	997,223		997,223
Utilities	286,559		286,559
Mutual funds:			
Bond fund	8,443,926		8,443,926
International fund	541,268		541,268
Mid cap fund	231,283		231,283
Small cap fund	300,665		300,665
Municipal bonds		776,057	776,057
Exchange traded fund		182,223	182,223
Total assets at fair value	$16,847,449	$32,080,086	$48,927,535

Note 4. Other Assets

Other assets consist of the following:

	2013	2012
Prepaid building maintenance		$ 1,500
Prepaid administrative fees	$248,861	270,919
Prepaid management fees	11,304	
Due from KACo-Workers Compensation Fund	4,495	
	$264,660	$272,419

Note 5. Estimated Unpaid Claims Liabilities

Under Kentucky Law, the Fund is required to pay all valid claims against its members.

The estimated liability for future claims, net of estimated recoveries for reinsurance, deductibles and subrogation was determined by Fund management as a result of consultation with the Fund's actuaries, Oliver Wyman Actuarial Consulting, Inc. for the year ended June 30, 2013 and both Oliver Wyman Actuarial Consulting, Inc. and By The Numbers Actuarial Consulting, Inc. for the year ended June 30, 2012.

The actuaries provide a range of the estimated liability for unpaid claims. Management selects an amount in that range which they believe represents a reasonable estimate of the ultimate liability. This estimate is based upon various factors such as loss control efforts, claim trends and historical claims information.

To the extent that claims information varies from management's estimates, the statement of revenues, expenses and changes in members' equity reflect adjustments in the year they occur.

For the year ended June 30, 2013, the liability selected by management was the mid-range or "best estimate" as determined by Oliver Wyman Actuarial Consulting, Inc. discounted at 4.0% based upon an estimate of the Fund's yield on its investments and expected claims payment patterns as developed by the actuary. For the year ended June 30, 2012, the liability selected by management was the average of the mid-range or "best estimate" as determined by the actuaries and was discounted at 4.0% based on the Fund's yield on its investments and expected claims payment patterns as developed by the actuaries. The loss payment pattern used could vary significantly from actual, which would have a direct effect on the liability for estimated claims. The liability, without consideration for the time value of money for 2013 and 2012, respectively, was approximately $ and $

The Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities, net of recoveries, for the years ended June 30, 2013 and 2012:

	2013	2012
Unpaid claims and claim adjustment expenses at beginning of year	$	
Incurred claims and claim adjustment expenses:		
Provision for insured events of current year and increases in provision for insured events of prior years net of recoveries		
Payments:		
Claim and claim adjustment expenses paid attributable to insured events of current and prior years net of recoveries collected		
Unpaid claims and claim adjustment expenses at end of year	$41,459,000	$44,525,000

Note 6. Unallocated Loss Adjustment Expenses

An estimated liability for future expenses of handling prior year claims has been determined by management and the Fund's actuaries as of June 30, 2013 and 2012, and recorded as unallocated loss adjustment expenses.

Note 7. Concentration of Credit Risk

The Fund maintains its cash accounts at various banks in Kentucky. Accounts at each bank are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. At June 30, 2013, the uninsured cash balances totaled approximately $9,260,000.

Note 8. Related Party Transactions

The Fund purchases employee dishonesty fidelity bond coverage and business income/extra expense coverage from Commonwealth Insurance Company, Inc., which is a wholly owned subsidiary of Kentucky Association of Counties Leasing Trust (COLT) and a related party of KACo. Expense for the years ended June 30, 2013 and 2012 was $1,119,010 and $1,072,295, respectively.

NOTES TO FINANCIAL STATEMENTS

The Fund is under a Program Administration Agreement with KACo in which the Fund reimburses KACo for certain management and administrative expenses. Total fees for the years ended June 30, 2013 and 2012 were $1,218,739 and $1,232,333, respectively. As of June 30, 2013 and 2012, the Fund had prepaid administrative fees of $248,861 and $270,919, respectively.

The Fund is under a Program Administration Agreement with KACo in which the Fund pays KACo for certain management services. The fee is based on 2% of earned premiums collected. For the years ended June 30, 2013 and 2012, the agreement included a base management fee of $350,000 and $347,120, respectively, in addition to the 2% of earned premiums collected. Total fees for the years ended June 30, 2013 and 2012 were $952,936 and $936,486, respectively. As of June 30, 2013 and 2012, the Fund had a prepaid of $11,304 and a payable of $215, respectively, to KACo.

The Fund has a licensing agreement with KACo that requires the Fund to pay a royalty to KACo in return for the use of KACo's name and logo. For each of the years ended June 30, 2013 and 2012, the royalty was a fixed amount of $1,000.

KACo established the Kentucky Association of Counties Program Guaranty Fund. The purpose of the Guaranty Fund is to make available, on an as needed basis, financial support to the various programs sponsored by and operating under service agreements with KACo, which includes the Fund. The Guaranty Fund receives contributions from KACo and certain of its programs. The Fund did not make any contributions to the Guaranty Fund for the years ended June 30, 2013 and 2012.

KACo established the KACo Finance Corporation. The purpose of the Finance Corporation is to create a statewide bond pool system to allow counties and eligible subdivisions to issue bonds carrying an AA rating. As of June 30, 2013 and 2012, the Fund has purchased $2,280,000 and $2,095,000, respectively, of bonds of the KACo Finance Corporation, which are held in trust at Central Bank & Trust Company.

The Fund has a receivable due from KACo-Workers Compensation Fund at June 30, 2013 in the amount of $4,495 for claims that were incorrectly charged and paid by the Fund.