KENTUCKY ASSOCIATION OF COUNTIES - ALL LINES FUND

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

Years Ended June 30, 2011 and 2010

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 balance sheets of Kentucky Association of Counties - All Lines Fund as of June 30, 2011 and 2010, and the related statements of revenues, expenses and changes in members' equity and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Association of Counties - All Lines Fund as of June 30, 2011 and 2010 and changes in members' equity and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deming, Malone, Livesay & Ostroff

Louisville, Kentucky
October 19, 2011

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

KENTUCKY ASSOCIATION OF COUNTIES -
ALL LINES FUND

BALANCE SHEETS
June 30, 2011 and 2010

ASSETS	2011	2010
Cash and cash equivalents	$ 8,541,121	$ 6,122,924
Investments	53,046,124	53,987,468
Member premiums receivable	27,195,685	27,392,578
Accrued interest receivable	231,785	264,217
Other	287,861	251,660
Total assets	$ 89,302,576	$ 88,018,847

LIABILITIES AND MEMBERS' EQUITY		
Estimated liability for future claims, net of estimated recoveries:		
	$	$
	40,354,000	36,900,000
Unallocated loss adjustment expenses	175,000	183,000
Dividend payable		2,998,310
Deferred revenue	29,323,639	28,786,326
Accounts payable	281,838	263,030
Total liabilities	70,134,477	69,130,666
MEMBERS' EQUITY	19,168,099	18,888,181
Total liabilities and members' equity	$ 89,302,576	$ 88,018,847

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, 2011 and 2010

	2011	2010
REVENUES		
Member premiums	$ 28,807,828	$ 28,770,436
Investment income	1,780,331	1,696,728
Realized and unrealized gain on investments	1,625,714	1,043,318
Total revenues	32,213,873	31,510,482
EXPENSES		
Claims expense, net of recoveries		
Reinsurance premiums		
Administration and marketing		
Professional fees		
Management expense		
Total expenses	31,933,955	31,471,633
Excess of revenues over expenses before distributions to members	279,918	38,849
NET DISTRIBUTIONS TO MEMBERS		(2,998,310)
Increase (decrease) in members' equity	279,918	(2,959,461)
Members' equity, beginning of year	18,888,181	21,847,642
Members' equity, end of year	$ 19,168,099	$ 18,888,181

See Notes to Financial Statements.

KENTUCKY ASSOCIATION OF COUNTIES -
ALL LINES FUND

STATEMENTS OF CASH FLOWS
Years Ended June 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash received from member premiums	$ 28,024,284	$ 28,057,074
Reinsurance and other recoveries collected	4,510,936	369,387
Cash paid to suppliers	(12,419,193)	(12,831,097)
Claims paid	(20,597,091)	(17,821,561)
Investment income received	1,812,763	1,686,000
Net cash provided by (used in) operating activities	1,331,699	(540,197)
Cash flows from investing activities:		
Purchase of investments	(22,176,611)	(29,875,492)
Proceeds from sale of investments	24,743,669	17,284,634
Net cash provided by (used in) investing activities	2,567,058	(12,590,858)
Cash flows from financing activities:		
Distributions paid to members	(1,480,560)	
Net increase (decrease) in cash and cash equivalents	2,418,197	(13,131,055)
Cash and cash equivalents at beginning of year	6,122,924	19,253,979
Cash and cash equivalents at end of year	$ 8,541,121	$ 6,122,924

SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES

In August 2009, the Board of Trustees of the Fund declared a $2,998,310 distribution for the policy year ended June 30, 2006 payable to its eligible members. $1,517,750 of the total distributions were applied against the 2010-2011 member premiums, at the option of those electing members (see Note 5).

See Notes to Financial Statements.

RECONCILIATION OF EXCESS OF REVENUES OVER EXPENSES TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES

	2011	2010
Excess of revenues over expenses	$ 279,918	$ 38,849
Adjustments to reconcile excess of revenues over expenses to net cash provided by (used in) operating activities:		
Realized and unrealized gains on investments	(1,625,714)	(1,043,318)
Dividend credits taken by members for member premiums	(1,517,750)	
Changes in assets and liabilities:		
Decrease (increase) in:		
Member premiums receivable	196,893	(879,278)
Accrued interest receivable	32,432	(10,728)
Other	(36,201)	25,640
Increase (decrease) in:		
Estimated liability for future claims	3,454,000	1,200,000
Unallocated loss adjustment expense	(8,000)	7,000
Deferred revenue	537,313	165,916
Accounts payable	18,808	(44,278)
Total adjustments	1,051,781	(579,046)
Net cash provided by (used in) operating activities	$ 1,331,699	$ (540,197)

KENTUCKY ASSOCIATION OF COUNTIES - ALL LINES FUND

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 cost 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 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 112 counties and 581 political subdivisions for 2011.

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.

NOTES TO FINANCIAL STATEMENTS

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 and FSC Securities Corporation. 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.

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.

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.

A significant estimate in these financial statements is the estimated liability for future claims (see Note 6).

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.

NOTES TO FINANCIAL STATEMENTS

Allowance for uncollectible accounts:

As of June 30, 2011 and 2010, 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 collectability. No provision for doubtful accounts has been made at June 30, 2011 and 2010, as management considers all amounts fully collectible.

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.

The Fund follows the guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions in an organization's financial statements. Income tax positions must meet a more-likely-than-not recognition threshold to be recognized. The following of this guidance did not have an effect on the Fund's financial position and results of operations.

As of June 30, 2011 and 2010, 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.

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.

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.

Subsequent events:

Subsequent events have been evaluated through October 19, 2011, 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 trust funds by Central Bank & Trust Company and FSC Securities Corporation at June 30, 2011 consisted of the following:

	Face Value	Cost	Fair Market Value
Mortgage-Backed Securities:			
Federal Home Loan Bank	$ 9,039,286	$ 9,067,225	$ 9,162,807
FNMA	13,300,000	13,294,375	13,251,483
Federal Farm Credit Banks	5,500,000	5,500,000	5,565,515
	27,839,286	27,861,600	27,979,805
Corporate bonds	6,410,000	6,477,081	6,817,325
Common stocks		6,652,553	7,652,443
Mutual funds		9,470,810	9,673,357
Municipal bonds		691,871	755,815
Other investments		170,024	167,379
Total investments		$51,323,939	$53,046,124

NOTES TO FINANCIAL STATEMENTS

Investments held in trust funds by Central Bank & Trust Company and FSC Securities Corporation at June 30, 2010 consisted of the following:

	Face Value	Cost	Fair Market Value
Mortgage-Backed Securities:			
Federal Home Loan Bank	$ 9,845,000	$ 9,866,439	$ 10,065,228
Federal Home Loan Mortgage	1,500,000	1,500,000	1,523,595
FNMA	16,500,000	16,496,165	16,670,196
Federal Farm Credit Banks	3,000,000	3,000,000	3,042,180
	30,845,000	30,862,604	31,301,199
Corporate bonds	5,750,000	5,833,303	6,231,105
Common stocks		6,956,219	6,048,067
Mutual funds		9,376,230	9,420,799
Municipal bonds		691,871	737,444
Other investments		324,126	248,854
Total investments		$54,044,353	$53,987,468

The aggregate annual maturities of the fair market value of investments at June 30, 2011, based upon stated maturity dates are as follows:

Due within one to five years	$15,709,478
Due within five to ten years	18,183,467
Due after ten years	1,660,000
Common stocks	7,652,443
Mutual funds	9,673,357
Other investments	167,379
	$53,046,124

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, 2011.

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

Corporate bonds, municipal bonds, other investments 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.

NOTES TO FINANCIAL STATEMENTS

The following table sets forth, by level, within the fair value hierarchy, the Fund's assets at fair value as of June 30, 2011 and 2010:

	June 30, 2011		
	Level 1	Level 2	Total
Mortgage-backed securities	$27,979,805		$27,979,805
Mutual funds:			
Bond fund	$ 8,480,800		8,480,800
International fund	613,502		613,502
Mid cap fund	256,048		256,048
Small cap fund	323,007		323,007
Corporate bonds	5,157,325	1,660,000	6,817,325
Common stocks:			
Basic materials	1,121,837		1,121,837
Consumer goods	385,428		385,428
Financial	1,215,858		1,215,858
Healthcare	509,461		509,461
Industrial goods	1,382,492		1,382,492
Services	1,114,489		1,114,489
Technology	1,672,197		1,672,197
Utilities	250,681		250,681
Municipal bonds	755,815		755,815
Exchange traded fund	167,379		167,379
Total assets at fair value	$51,386,124	$1,660,000	$53,046,124

	June 30, 2010		
	Level 1	Level 2	Total
Mortgage-backed securities	$31,301,199		$31,301,199
Mutual funds:			
Bond fund	$ 8,229,743		8,229,743
International fund	486,233		486,233
Mid cap fund	192,424		192,424
Precious metals fund	271,079		271,079
Small cap fund	241,320		241,320
Corporate bonds	6,231,105		6,231,105
Common stocks:			
Basic materials	946,965		946,965
Consumer goods	316,735		316,735
Financial	938,923		938,923
Healthcare	470,975		470,975
Industrial goods	979,196		979,196
Other	43,260		43,260
Services	713,766		713,766
Technology	1,427,848		1,427,848
Utilities	210,399		210,399
Municipal bonds	737,444		737,444
Exchange traded fund	248,854		248,854
Total assets at fair value	$53,987,468	$	$53,987,468

Note 4. Other Assets

Other assets consist of the following:

	2011	2010
Prepaid management fee	$ 1,592	$ 201
Prepaid building maintenance	4,500	7,500
Prepaid administrative fees	237,688	155,797
Prepaid loss control	44,081	88,162
	$287,861	$251,660

Note 5. Distributions to Members

During August 2009, the Board of Trustees declared a distribution to the Fund's members, payable in July 2010. The members had the option of receiving full payment of their individual distribution, or instead, applying their distribution as a payment towards their 2010-2011 member premiums. Of the total declared distribution of $2,998,310, $1,480,560 was paid out with the remaining $1,517,750 being applied towards the 2010-2011 member premiums.

Note 6. 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. and By The Numbers Actuarial Consulting, Inc. for the years ended June 30, 2011 and 2010.

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 each of the years ended June 30, 2011 and 2010, the liability selected by management was the mid-range or "best estimate" as determined by the actuaries and was discounted at 5.0%, based upon an estimate of 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 2011 and 2010, 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, 2011 and 2010:

	2011	2010
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	$40,354,000	$36,900,000

Note 7. 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, 2011 and 2010, and recorded as unallocated loss adjustment expenses.

Note 8. 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, 2011, the uninsured cash balances totaled approximately $8,000,000.

Note 9. 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, 2011 and 2010 was $965,535 and $924,192, respectively.

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, 2011 and 2010 were $1,191,385 and $1,347,376, respectively. As of June 30, 2011 and 2010, the Fund had prepaid administrative fees of $237,688 and $155,797, 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 year ended June 30, 2011 and 2010, the agreement included a base management fee of $366,500 and $279,000, respectively, in addition to the 2% of earned premiums collected. Total fees for the years ended June 30, 2011 and 2010 were $941,037 and $852,848, respectively. As of June 30, 2011 and 2010, the Fund had a prepaid to KACo of $1,592 and $201, respectively.

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 the years ended June 30, 2011 and 2010, 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 Guarantee 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, 2011 or 2010.

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, 2011, the Fund has purchased a $1,660,000 bond in the KACo Finance Corporation, which is held in trust at Central Bank & Trust Company.