

# Kentucky Associated General Contractors Self Insurers' Fund

Financial Statements as of and for the  
Years Ended December 31, 2013 and 2012,  
and Independent Auditors' Report

# KENTUCKY ASSOCIATED GENERAL CONTRACTORS SELF INSURERS' FUND

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## INDEPENDENT AUDITORS' REPORT

To the Board of Trustees  
Kentucky Associated General Contractors  
Self Insurers' Fund  
Louisville, Kentucky

We have audited the accompanying financial statements of Kentucky Associated General Contractors Self Insurers' Fund (the "Fund"), which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of income and comprehensive income, changes in fund balance, 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 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 Fund'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 Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Associated General Contractors Self Insurers' Fund as of December 31, 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.

*Deloitte & Touche LLP*

March 31, 2014

# KENTUCKY ASSOCIATED GENERAL CONTRACTORS SELF INSURERS' FUND

## BALANCE SHEETS AS OF DECEMBER 31, 2013 AND 2012

	2013	2012
<b>ASSETS</b>		
CASH AND CASH EQUIVALENTS	\$ 26,500,513	\$ 21,628,170
INVESTMENTS	301,031,771	303,548,431
RECEIVABLES:		
Premiums	8,516,715	8,696,469
Aggregate excess insurance	466,868	392,164
Specific excess insurance	32,781,054	33,800,322
Accrued interest	1,541,821	1,903,010
Income taxes receivable		830,249
PREPAID REINSURANCE	<u>1,118,241</u>	<u>951,168</u>
TOTAL	<u>\$371,956,983</u>	<u>\$371,749,983</u>
<b>LIABILITIES AND FUND BALANCE</b>		
LIABILITIES:		
Estimated liability for claims:		
Incurred and reported	\$ 136,997,943	\$ 143,907,258
Incurred but not reported and loss adjustment expense	<u>115,404,523</u>	<u>114,927,882</u>
Total estimated liability for claims	<u>252,402,466</u>	<u>258,835,140</u>
Payables and accrued expenses:		
Premiums refundable	1,299,252	1,294,669
Service fee and other fees payable	4,434,203	3,837,547
Member deposits	10,453,316	10,621,007
Tax assessments collected on premiums	979,837	919,558
Deferred tax liability	7,303,115	5,722,124
Income taxes payable	2,028,842	
Accrued member dividends	<u>37,952,615</u>	<u>44,770,741</u>
Total liabilities	<u>316,853,646</u>	<u>326,000,786</u>
FUND BALANCE:		
Retained earnings	37,836,366	29,749,911
Accumulated other comprehensive income — net of income taxes	<u>17,266,971</u>	<u>15,999,286</u>
Total fund balance	<u>55,103,337</u>	<u>45,749,197</u>
TOTAL	<u>\$371,956,983</u>	<u>\$371,749,983</u>

See notes to financial statements.

**KENTUCKY ASSOCIATED GENERAL CONTRACTORS  
SELF INSURERS' FUND**

**STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
REVENUES:		
Premiums earned	\$ 60,355,761	\$ 58,481,676
Net investment income	7,472,206	8,661,624
Net realized investment gains	479,855	1,006,478
Other	<u>573,841</u>	<u>771,443</u>
Total revenues	<u>68,881,663</u>	<u>68,921,221</u>
EXPENSES:		
Claims incurred	30,753,104	42,719,977
Service fee	6,536,529	6,333,566
Commissions	6,035,576	5,848,168
Excess insurance premiums	840,000	840,000
Loss control	861,009	893,104
Premium audits	532,618	564,136
Other operating expenses	<u>2,770,001</u>	<u>1,666,065</u>
Total expenses	<u>48,328,837</u>	<u>58,865,016</u>
INCOME BEFORE DIVIDENDS DECLARED TO MEMBERS AND INCOME TAX EXPENSE	20,552,826	10,056,205
DIVIDENDS DECLARED TO MEMBERS	<u>8,600,000</u>	<u>9,300,000</u>
INCOME BEFORE INCOME TAX EXPENSE	11,952,826	756,205
INCOME TAX EXPENSE	<u>3,866,371</u>	<u>5,928</u>
NET INCOME	<u>8,086,455</u>	<u>750,277</u>
OTHER COMPREHENSIVE INCOME — Before tax — unrealized gains (losses) on investments:		
Unrealized holding gains arising during the year	2,400,588	3,593,058
Reclassification adjustment for gains included in net income	<u>(479,855)</u>	<u>(1,006,478)</u>
OTHER COMPREHENSIVE INCOME — Before tax	1,920,733	2,586,580
INCOME TAX EXPENSE RELATIVE TO OTHER COMPREHENSIVE INCOME	<u>(653,048)</u>	<u>(879,437)</u>
OTHER COMPREHENSIVE INCOME — Net of tax	<u>1,267,685</u>	<u>1,707,143</u>
COMPREHENSIVE INCOME	<u>\$ 9,354,140</u>	<u>\$ 2,457,420</u>

See notes to financial statements.

**KENTUCKY ASSOCIATED GENERAL CONTRACTORS  
SELF INSURERS' FUND**

**STATEMENTS OF CHANGES IN FUND BALANCE  
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

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	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Fund Balance</b>
BALANCE — December 31, 2011	\$28,999,634	\$ 14,292,143	\$43,291,777
Net income	750,277		750,277
Change in accumulated other comprehensive income — net of income taxes	<u>                    </u>	<u>1,707,143</u>	<u>1,707,143</u>
BALANCE — December 31, 2012	29,749,911	15,999,286	45,749,197
Net income	8,086,455		8,086,455
Change in accumulated other comprehensive income — net of income taxes	<u>                    </u>	<u>1,267,685</u>	<u>1,267,685</u>
BALANCE — December 31, 2013	<u>\$37,836,366</u>	<u>\$ 17,266,971</u>	<u>\$55,103,337</u>

See notes to financial statements.

# KENTUCKY ASSOCIATED GENERAL CONTRACTORS SELF INSURERS' FUND

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 8,086,455	\$ 750,277
Adjustments to reconcile net income to net cash provided by operating activities:		
Dividends declared to members	8,600,000	9,300,000
Gain on sale of investments	(479,855)	(1,006,478)
Deferred tax benefit liability	927,943	(2,816)
Amortization of investment premiums and discounts — net	1,128,302	(1,782,305)
Changes in assets and liabilities:		
Receivables	1,485,507	(137,033)
Prepaid insurance	(167,073)	
Income taxes receivable	2,859,091	(716,256)
Estimated liability for claims	(6,432,674)	6,126,594
Payables and accrued expenses	601,239	(121,089)
Member deposits	(167,691)	(365,227)
Tax assessments collected on premiums	<u>60,279</u>	<u>(9,276)</u>
Net cash provided by operating activities	<u>16,501,523</u>	<u>12,036,391</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of investments	(64,634,165)	(112,298,432)
Proceeds from sales and maturities of investments	<u>68,423,111</u>	<u>107,247,647</u>
Net cash provided by (used in) investing activities	<u>3,788,946</u>	<u>(5,050,785)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITY — Payment of dividends to members</b>		
	<u>(15,418,126)</u>	<u>(13,907,611)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	4,872,343	(6,922,005)
<b>CASH AND CASH EQUIVALENTS — Beginning of year</b>	<u>21,628,170</u>	<u>28,550,175</u>
<b>CASH AND CASH EQUIVALENTS — End of year</b>	<u>\$ 26,500,513</u>	<u>\$ 21,628,170</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION — Cash paid for income taxes</b>		
	<u>\$ 275,000</u>	<u>\$ 823,327</u>

See notes to financial statements.



# KENTUCKY ASSOCIATED GENERAL CONTRACTORS SELF INSURERS' FUND

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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### 1. OPERATIONS OF THE FUND

Kentucky Associated General Contractors Self Insurers' Fund's (the "Fund") purpose is to meet and fulfill employer member obligations and liabilities under the Kentucky Workers' Compensation Act, pursuant to KRS Section 342.350. The operations of the Fund are covered under a Trust Agreement. Insurance coverage is provided to members of construction industry associations in Kentucky. Claims administration and management services are provided by Ladegast & Heffner Claims Service under a contract that extends through December 31, 2018. The service fee is based on a percentage of premiums earned.

### 2. SIGNIFICANT ACCOUNTING POLICIES

**Cash and Cash Equivalents** — Cash equivalents include money market funds and certain investments in highly liquid debt instruments with maturities of 3 months or less, which are stated at cost, which approximates fair value. The Fund's bank balances are held at a single financial institution, and at times, balances may exceed federally insured amounts.

**Investments** — Investments are classified as available-for-sale securities and are reported at fair value. Unrealized holding gains and losses, net of income taxes, are reported as accumulated other comprehensive income, a separate component of fund balance, until realized. The specific identification method is used to determine cost to compute realized gains or losses. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Observable inputs or unobservable inputs, defined by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements*, may be used in the calculation of fair value. ASC Topic 820 establishes 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 below:

*Level 1* — Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

*Level 2* — Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly;

*Level 3* — Prices or valuations that require inputs that are both significant to the fair value measure and unobservable.

In accordance with ASC Topic 820, assets measured at fair value on a recurring basis at December 31 are as follows:

2013	Recurring Fair Value Measures			
	Level 1	Level 2	Level 3	Total
Investment securities — available-for-sale securities:				
US Treasury notes and bonds	\$ 186,736,509	\$ -	\$ -	186,736,509
Domestic common stocks:				
Technology common stocks	7,842,413			7,842,413
Basic material common stocks	6,245,324			6,245,324
Financial common stocks	7,274,286			7,274,286
Other common stocks and mutual bonds	39,306,041			39,306,041
Corporate obligations		28,816,717		28,816,717
Municipal obligations		24,408,012		24,408,012
Other	402,469			402,469
Total	<u>\$ 247,807,042</u>	<u>\$ 53,224,729</u>	<u>\$ -</u>	<u>\$ 301,031,771</u>
2012	Recurring Fair Value Measures			
	Level 1	Level 2	Level 3	Total
Investment securities — available-for-sale securities:				
US Treasury notes and bonds	\$ 212,490,413	\$ -	\$ -	\$ 212,490,413
Domestic common stocks:				
Technology common stocks	6,022,543			6,022,543
Basic material common stocks	4,532,222			4,532,222
Financial common stocks	4,074,895			4,074,895
Other common stocks and mutual bonds	28,611,229			28,611,229
Corporate obligations		31,193,580		31,193,580
Municipal obligations		16,060,480		16,060,480
Other	563,069			563,069
Total	<u>\$ 256,294,371</u>	<u>\$ 47,254,060</u>	<u>\$ -</u>	<u>\$ 303,548,431</u>

The Fund does not value any liabilities at fair value. The Fund does not measure any assets or liabilities at fair value on a nonrecurring basis. For all other classes of financial instruments, the carrying amount approximates fair value due to the short-term nature of the asset or liability.

Investments, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. It is reasonably possible that changes in the investment values could occur in the near term and that such changes could materially affect the amounts reported in the balance sheets.

**Estimated Liability for Claims** — Estimates of the liability for incurred (reported and not reported) claims are actuarially determined using development factor methods. These methods use past observed patterns of the time between when a claim is incurred and when a claim is paid to estimate incurred claims from available paid claims information. Liabilities are based on the estimated ultimate cost of settling the claims. The unpaid claims liabilities are necessarily based on estimates and, accordingly, the ultimate liability may be in excess of or less than the amounts provided. Adjustments to the estimated liability for claims are charged or credited to expense in the periods in which they become known. Any adjustments could be material to the financial statements. In accordance with ASC Topic 210, *Balance Sheet — Offsetting*, estimated amounts of excess insurance recoverable are shown as assets, and are not netted against the estimated liability for claims as of December 31, 2013. The estimated liability for claims is discounted using an interest rate of 2.75%.

**Member Dividends** — Distributions to members in the form of dividends may be declared by the Board of Trustees, but under Kentucky Department of Insurance Regulations, dividends may not be paid until the end of the thirty-sixth month after the expiration of the self-insurance term. The Fund reflects dividends as a charge to income and a liability in the year declared.

**Premiums Earned** — The Fund enters into individual workers' compensation insurance policy contracts with each Member Company, thus forming a group self-insured fund. Premiums are due at the beginning of each month based on the previous month's exposure plus any current period known charges. Premiums are recognized as revenue during the period in which the Fund is obligated to provide coverage to said group of employers.

**Member Deposits** — Member deposits represent 25% of each member's estimated normal premium at the inception of membership in the Fund. Member deposits are subject to periodic updates based on each member's most recent audited premium. Once a member's coverage through the Fund has been terminated and all outstanding balances due to the Fund or the applicable trade association have been paid, the member's deposit will be refunded.

**Use of Estimates** — Financial statements prepared in conformity with accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

**Subsequent Events** — There were no subsequent events requiring adjustment to the financial statements or disclosure through March 31, 2014, the date that the financial statements were available for issuance.

**Recent Accounting Pronouncements** — In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, "or ASU 2013-02" which requires disclosure of significant amounts reclassified out of accumulated other comprehensive income by component and their corresponding effect on the respective line items of net income. This guidance was effective for reporting periods beginning after December 15, 2012 and did not have a material impact on the Fund's consolidated financial statements or financial statement disclosures.

### 3. INVESTMENTS

Investments as of December 31, 2013 and 2012, consist of the following:

	<b>2013</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. Treasury notes and bonds	\$ 181,558,760	\$ 7,783,628	\$ (2,605,879)	\$ 186,736,509
Domestic common stocks:				
Technology common stocks	5,844,633	1,997,780		7,842,413
Basic material common stocks	4,201,163	2,188,496	(144,335)	6,245,324
Financial common stocks	4,779,220	2,495,066		7,274,286
Other common stocks and mutual bonds	24,545,903	14,760,138		39,306,041
Corporate obligations	28,205,966	993,066	(382,315)	28,816,717
Municipal obligations	25,333,772	11,361	(937,121)	24,408,012
Other	400,283	2,186		402,469
<b>Total</b>	<b><u>\$ 274,869,700</u></b>	<b><u>\$ 30,231,721</u></b>	<b><u>\$ (4,069,650)</u></b>	<b><u>\$ 301,031,771</u></b>
	<b>2012</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. Treasury notes and bonds	\$ 199,257,685	\$ 13,318,044	\$ (85,316)	\$ 212,490,413
Domestic common stocks:				
Technology common stocks	5,382,201	667,774	(27,432)	6,022,543
Basic material common stocks	3,526,484	1,211,358	(205,620)	4,532,222
Financial common stocks	3,216,452	858,443		4,074,895
Other common stocks and mutual bonds	21,868,502	6,742,727		28,611,229
Corporate obligations	29,493,933	1,738,533	(38,886)	31,193,580
Municipal obligations	16,000,000	95,520	(35,040)	16,060,480
Other	561,834	1,235		563,069
<b>Total</b>	<b><u>\$ 279,307,091</u></b>	<b><u>\$ 24,633,634</u></b>	<b><u>\$ (392,294)</u></b>	<b><u>\$ 303,548,431</u></b>

The components of net investment income as of December 31, 2013 and 2012, are presented below:

	<b>2013</b>	<b>2012</b>
Investment income:		
Interest on fixed income securities	\$ 6,559,133	\$ 7,825,176
Dividends on equity securities	1,340,408	1,235,769
Other investment income	1,581	7,256
Less investment expense	<u>(428,916)</u>	<u>(406,577)</u>
<b>Net investment income</b>	<b><u>\$ 7,472,206</u></b>	<b><u>\$ 8,661,624</u></b>

The components of net realized investment gains included in earnings as of December 31, 2013 and 2012, are as follows:

	<b>2013</b>	<b>2012</b>
Net realized investment gains:		
Fixed income:		
Gross realized gains	\$ 344,457	\$ 1,107,780
Gross realized losses	(372,263)	(165,035)
Equity securities:		
Gross realized gains	507,661	1,061,599
Gross realized losses	<u>                    </u>	<u>(997,866)</u>
Net realized investment gains	<u>\$ 479,855</u>	<u>\$ 1,006,478</u>

Debt instruments held as of December 31, 2013, will mature as follows:

<b>Maturing</b>	<b>Amortized Cost</b>	<b>Fair Value</b>
Within 1 year	\$ 36,462,258	\$ 36,688,945
After 1 year through 5 years	111,628,880	117,106,838
After 5 years through 10 years	<u>87,007,360</u>	<u>86,165,455</u>
Total	<u>\$235,098,498</u>	<u>\$239,961,238</u>

In lieu of purchasing a bond, as required by the Kentucky Department of Insurance, the Fund has pledged approximately \$26,041,868 of investments, at fair value, as collateral for the payment of workers' compensation claims as of December 31, 2013. The amount pledged is to remain under the joint control of the Fund and the Department of Insurance, for the exclusive payment of any liability for workers' compensation claims incurred by the Fund.

The following tables provide the unrealized losses and fair values, by investment category and by length of time the individual securities have been in a continuous unrealized loss position, at December 31, 2013 and 2012:

	<b>2013</b>					
	<b>Less than 12 Months</b>		<b>12 Months or More</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
U.S. Treasury notes and bonds	\$ 69,825,541	\$(2,374,741)	\$ 9,763,150	\$(231,138)	\$ 79,588,691	\$(2,605,879)
Domestic common stocks:						
Basic material common stocks			636,283	(144,335)	636,283	(144,335)
Corporate obligations	10,356,902	(382,315)			10,356,902	(382,315)
Municipal obligations	<u>22,384,050</u>	<u>(937,121)</u>			<u>22,384,050</u>	<u>(937,121)</u>
Total	<u>\$102,566,493</u>	<u>\$(3,694,177)</u>	<u>\$10,399,433</u>	<u>\$(375,473)</u>	<u>\$112,965,926</u>	<u>\$(4,069,650)</u>

	2012					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury notes and bonds	\$24,236,433	\$ (28,967)	\$2,009,840	\$ (56,349)	\$26,246,273	\$ (85,316)
Domestic common stocks:						
Technology common stocks	1,838,659	(27,432)			1,838,659	(27,432)
Basic material common stocks			574,998	(205,620)	574,998	(205,620)
Other common stocks and mutual bonds	8,824,525	(38,886)			8,824,525	(38,886)
Corporate obligations	12,964,960	(35,040)			12,964,960	(35,040)
Total	<u>\$47,864,577</u>	<u>\$(130,325)</u>	<u>\$2,584,838</u>	<u>\$(261,969)</u>	<u>\$50,449,415</u>	<u>\$(392,294)</u>

At December 31, 2013, one equity security with a total unrealized loss of \$144,335 was in that position for 12 months or more; and two corporate obligations with a total unrealized loss of \$231,138 were in loss positions for 12 months or more. Based on consideration of various factors, such as credit quality of the bonds, no event of default of issuer, or government guarantee of principle, these assets presently do not meet the Fund's other-than-temporary asset impairment criteria and will not be impaired unless it meets the impairment criteria in the future.

Bond fair values are subject to fluctuation based on, among other things, changes in interest rates. In a rising rate environment, bond values may experience a drop in market price which is normally recovered as the bond approaches its maturity date. The Fund has the intent and ability to hold all bond investments until recovery. At December 31, 2013, the Fund did not have the intent to sell any bonds whose fair value was less than amortized cost, it was not more likely than not the Fund would be required to sell such securities, and the present values of the expected future cash flows are sufficient to recover the entire amortized cost of the securities.

#### 4. EXCESS INSURANCE

The Fund uses excess insurance agreements to limit its exposure on payment of claims. Excess insurance permits recovery of a portion of claims incurred from excess insurers, although it does not discharge the Fund from the primary liability as direct insurer. The amount of excess insurance coverage varies during each of the excess insurance periods.

Aggregate excess insurance provides coverage if the total losses of the Fund exceed certain percentages of earned premium. The Fund discontinued the purchase of aggregate excess coverage effective May 1, 1994 and has subsequently received an annual purchase waiver by fulfilling the requirements as set-forth by the Kentucky Department of Insurance. At December 31, 2013 and 2012, aggregate excess insurance receivables with an undiscounted value of \$534,144 and \$413,809, respectively, were associated primarily with one excess insurer.

Specific excess insurance provides coverage for each loss in excess of certain amounts. At December 31, 2013 and 2012, specific excess insurance receivables with an undiscounted value of \$37,716,512 and \$40,340,048, respectively, were associated primarily with one excess insurer. The Fund does not hold any collateral under any excess insurance agreements. In the event that any of the excess insuring companies might be unable to meet their obligations under existing excess insurance agreements, the Fund would be liable for such amounts.

## 5. ESTIMATED LIABILITY FOR CLAIMS

Activity in the estimated liability for claims at December 31, 2013 and 2012, is summarized as follows:

	<b>2013</b>	<b>2012</b>
Balance — January 1	\$ 258,835,140	\$ 240,141,275
Less excess insurance receivables	<u>34,192,486</u>	<u>20,953,794</u>
Net balance — January 1	<u>224,642,654</u>	<u>219,187,481</u>
Incurred related to:		
Current year — undiscounted	45,732,656	43,692,895
Increase (decrease) in prior years' estimates — undiscounted	<u>(1,218,571)</u>	<u>73,920</u>
Total incurred — undiscounted	44,514,085	43,766,815
Less effect of discounting reserves	<u>(13,637,108)</u>	<u>(1,046,821)</u>
Net incurred	<u>30,876,977</u>	<u>42,719,994</u>
Paid related to:		
Current year	6,913,295	8,505,506
Prior years	<u>29,451,791</u>	<u>28,759,315</u>
Total paid	<u>36,365,086</u>	<u>37,264,821</u>
Net balance — December 31	219,154,545	224,642,654
Plus excess insurance receivables	<u>33,247,921</u>	<u>34,192,486</u>
Balance — December 31	<u>\$ 252,402,466</u>	<u>\$ 258,835,140</u>

At December 31, 2013 and 2012, estimated liabilities for claims of \$261,972,606 and \$255,175,659, respectively, net of excess insurance receivables, are presented above at their discounted net present value of \$219,154,545 and \$224,642,654, respectively.

As a result of changes in estimates of insured events in prior years, the claims and claim adjustment expenses decreased by \$1,218,571 in 2013, reflecting lower-than-anticipated losses for claims for workers' compensation in the current year.

Estimated liabilities for claims and the related insurance recoverable at December 31, 2013 and 2012, are as follows:

	<b>2013</b>	<b>2012</b>
Estimated liability for claims — gross of excess insurance receivables	\$ 252,402,466	\$ 258,835,140
Less excess and specific insurance receivables	<u>(33,247,921)</u>	<u>(34,192,486)</u>
Estimated liability for claims — net of excess insurance receivables	<u>\$ 219,154,545</u>	<u>\$ 224,642,654</u>

In accordance with ASC Topic 210, *Balance Sheet — Offsetting*, estimated amounts of excess insurance recoverable are shown as assets, and are not netted against the estimated liability for claims as of December 31, 2013.

## 6. INCOME TAXES

The Fund's tax status is that of an insurance company subject to the provisions of Section 831 of the Internal Revenue Code of 1986, as amended. Under provisions of the Code, the Fund is permitted deductions for member dividends declared but not paid. The provision for federal income taxes is based upon an income tax return for the Fund as a stand-alone entity. The Fund has \$485,727 of alternative minimum tax credits to utilize against future taxes. These credits have no expiration. The Fund has no operating loss carry forwards and no capital loss carry forwards remaining at year-end.

The tax effects of temporary differences, which give rise to the deferred taxes at December 31, 2013 and 2012, are as follows:

	<b>2013</b>	<b>2012</b>
Estimated liability for claims	\$ 1,106,262	\$ 2,033,377
Capital loss carryover		107,501
Other	485,727	379,053
Net unrealized gain on investments	<u>(8,895,104)</u>	<u>(8,242,056)</u>
Net deferred tax liability	<u>\$ (7,303,115)</u>	<u>\$ (5,722,125)</u>

Income tax expense for the years ended December 31, 2013 and 2012, consist of the following:

	<b>2013</b>	<b>2012</b>
Current year expense	\$ 2,938,428	\$ 8,744
Deferred benefit	<u>927,943</u>	<u>(2,816)</u>
Income tax expense	<u>\$ 3,866,371</u>	<u>\$ 5,928</u>

ASC Topic 740, *Income Taxes*, prescribes a recognition threshold and measurement attribute for the recognition, measurement, presentation, and disclosure of uncertain tax positions that the Fund has taken or expects to take on a tax return. ASC Topic 740 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation process, based on the technical



merits of the income tax position. Income tax positions must meet a more likely than not recognition threshold to be recognized. As of December 31, 2013 and 2012, the Fund's liability for uncertain tax positions was not material. The company believes it is no longer subject to income tax examinations for years prior to 2010.

**7. RELATED PARTY TRANSACTIONS**

Service fee expenses to Ladegast & Heffner Claims Service were \$6,536,529 and \$6,333,566, for the years ended December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, service fee liabilities of \$806,743 and \$831,500, respectively, were due to Ladegast & Heffner Claims Service.

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