

Kentucky Associated General Contractors Self Insurers' Fund

Financial Statements as of and for the
Years Ended December 31, 2016 and 2015,
and Independent Auditors' Report

KENTUCKY ASSOCIATED GENERAL CONTRACTORS SELF INSURERS' FUND

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1-2
FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015:	
Balance Sheets	3
Statements of Income and Comprehensive Income (Loss)	4
Statements of Changes in Fund Balance	5
Statements of Cash Flows	6
Notes to Financial Statements	7-15

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, 2016 and 2015, and the related statements of income and comprehensive income (loss), 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, 2016 and 2015, 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

April 10, 2017

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

**BALANCE SHEETS
AS OF DECEMBER 31, 2016 AND 2015**

	2016	2015
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 28,291,100	\$ 22,785,542
INVESTMENTS—At fair value	327,009,991	322,186,090
RECEIVABLES:		
Premiums	10,016,261	10,224,994
Aggregate excess insurance	492,703	571,064
Specific excess insurance	26,195,771	25,934,709
Accrued interest	1,830,152	1,559,302
Income taxes receivable	2,723,187	-
PREPAID REINSURANCE	<u>1,150,300</u>	<u>1,021,800</u>
TOTAL	<u>\$397,709,465</u>	<u>\$384,283,501</u>
LIABILITIES AND FUND BALANCE		
LIABILITIES:		
Estimated liability for claims:		
Incurred and reported	\$140,865,452	\$142,973,881
Incurred but not reported and loss adjustment expense	<u>121,733,104</u>	<u>111,795,302</u>
Total estimated liability for claims	262,598,556	254,769,183
Payables and accrued expenses:		
Premiums refundable	1,287,211	1,296,810
Service fee and other fees payable	4,816,336	4,926,998
Member deposits	10,222,189	10,496,358
Tax assessments collected on premiums	1,201,414	1,332,223
Deferred tax liability	8,288,764	7,214,263
Income taxes payable	-	319,368
Accrued member dividends	<u>45,950,699</u>	<u>44,446,052</u>
Total liabilities	<u>334,365,169</u>	<u>324,801,255</u>
FUND BALANCE:		
Retained earnings	43,524,071	41,339,005
Accumulated other comprehensive income—net of income taxes	<u>19,820,225</u>	<u>18,143,241</u>
Total fund balance	<u>63,344,296</u>	<u>59,482,246</u>
TOTAL	<u>\$397,709,465</u>	<u>\$384,283,501</u>

See notes to financial statements.

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

**STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

	2016	2015
REVENUES:		
Premiums earned	\$63,184,381	\$62,303,802
Net investment income	7,475,262	7,300,245
Net realized investment gains	786,019	921,362
Other	<u>524,299</u>	<u>431,413</u>
Total revenues	<u>71,969,961</u>	<u>70,956,822</u>
EXPENSES:		
Claims incurred	40,771,976	39,155,508
Service fee	8,638,104	8,014,380
Commissions	6,305,186	6,221,233
Excess insurance premiums	1,152,000	1,104,000
Loss control	785,314	819,941
Premium audits	506,400	491,038
Other operating expenses	<u>2,197,868</u>	<u>2,145,597</u>
Total expenses	<u>60,356,848</u>	<u>57,951,697</u>
INCOME BEFORE DIVIDENDS DECLARED TO MEMBERS AND INCOME TAX EXPENSE	11,613,113	13,005,125
DIVIDENDS DECLARED TO MEMBERS	<u>8,860,000</u>	<u>8,950,000</u>
INCOME BEFORE INCOME TAX EXPENSE	2,753,113	4,055,125
INCOME TAX EXPENSE	<u>568,047</u>	<u>1,363,401</u>
NET INCOME	<u>2,185,066</u>	<u>2,691,724</u>
OTHER COMPREHENSIVE INCOME (LOSS)—Before tax— unrealized gains (losses) on investments:		
Unrealized holding gains (losses) arising during the year	3,326,903	(3,513,958)
Reclassification adjustment for gains included in net income	<u>(786,019)</u>	<u>(921,362)</u>
OTHER COMPREHENSIVE INCOME (LOSS)—Before tax	2,540,884	(4,435,320)
INCOME TAX (BENEFIT) EXPENSE RELATIVE TO OTHER COMPREHENSIVE INCOME (LOSS)	<u>(863,900)</u>	<u>1,508,374</u>
OTHER COMPREHENSIVE INCOME (LOSS)—Net of tax	<u>1,676,984</u>	<u>(2,926,946)</u>
COMPREHENSIVE INCOME (LOSS)	<u>\$ 3,862,050</u>	<u>\$ (235,222)</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, 2016 AND 2015**

	Retained Earnings	Accumulated Other Comprehensive Income	Fund Balance
BALANCE—December 31, 2014	\$38,647,281	\$21,070,187	\$59,717,468
Net income	2,691,724	-	2,691,724
Change in accumulated other comprehensive loss—net of income taxes	<u>-</u>	<u>(2,926,946)</u>	<u>(2,926,946)</u>
BALANCE—December 31, 2015	41,339,005	18,143,241	59,482,246
Net income	2,185,066	-	2,185,066
Change in accumulated other comprehensive income—net of income taxes	<u>-</u>	<u>1,676,984</u>	<u>1,676,984</u>
BALANCE—December 31, 2016	<u>\$43,524,071</u>	<u>\$19,820,225</u>	<u>\$63,344,296</u>

See notes to financial statements.

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

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,185,066	\$ 2,691,724
Adjustments to reconcile net income to net cash provided by operating activities:		
Dividends declared to members	8,860,000	8,950,000
Gain on sale of investments	(786,019)	(921,362)
Deferred tax benefit liability	210,602	296,761
Amortization of investment premiums and discounts—net	414,192	702,725
Changes in assets and liabilities:		
Receivables	(244,818)	(6,031,090)
Prepaid insurance	(128,500)	17,700
Income taxes receivable	(3,042,555)	1,066,639
Estimated liability for claims	7,829,373	9,343,025
Payables and accrued expenses	(120,261)	695,457
Member deposits	(274,169)	16,177
Tax assessments collected on premiums	<u>(130,809)</u>	<u>105,227</u>
Net cash provided by operating activities	<u>14,772,102</u>	<u>16,932,983</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(147,051,132)	(81,707,856)
Proceeds from sales and maturities of investments	<u>145,139,941</u>	<u>74,540,573</u>
Net cash used in investing activities	<u>(1,911,191)</u>	<u>(7,167,283)</u>
CASH FLOWS FROM FINANCING ACTIVITY—Payment of dividends to members		
	<u>(7,355,353)</u>	<u>(6,487,584)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	5,505,558	3,278,116
CASH AND CASH EQUIVALENTS—Beginning of year	<u>22,785,542</u>	<u>19,507,426</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 28,291,100</u>	<u>\$ 22,785,542</u>
SUPPLEMENTAL CASH FLOW INFORMATION—Cash paid for income taxes		
	<u>\$ 3,400,000</u>	<u>\$ 617,208</u>
NONCASH ACTIVITIES—Accrued Member Dividends	<u>\$ 45,950,699</u>	<u>\$ 44,446,052</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, 2016 AND 2015

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, 2021. 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 2 securities are valued using third-party pricing services. These services may use, for example, model-based pricing models that utilize observable market data as inputs. Broker-dealer bids or quotes of securities with similar characteristics may also be used. There were no transfers between Level 1 and Level 2 securities in the current year;

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:

2016	Recurring Fair Value Measures			
	Level 1	Level 2	Level 3	Total
Investment securities—available-for-sale securities:				
US Treasury notes and bonds	\$ 188,238,822	\$ -	\$ -	\$ 188,238,822
Domestic common stocks:				
Technology common stocks	12,189,552	-	-	12,189,552
Basic material common stocks	10,043,159	-	-	10,043,159
Financial common stocks	8,659,677	-	-	8,659,677
Healthcare common stocks	11,830,294	-	-	11,830,294
Other common stocks and mutual funds	35,712,599	-	-	35,712,599
Corporate obligations	-	34,843,239	-	34,843,239
Municipal obligations	-	25,088,240	-	25,088,240
Other	404,409	-	-	404,409
Total	<u>\$ 267,078,512</u>	<u>\$ 59,931,479</u>	<u>\$ -</u>	<u>\$ 327,009,991</u>
2015	Recurring Fair Value Measures			
	Level 1	Level 2	Level 3	Total
Investment securities—available-for-sale securities:				
US Treasury notes and bonds	\$ 195,279,098	\$ -	\$ -	\$ 195,279,098
Domestic common stocks:				
Technology common stocks	9,429,016	-	-	9,429,016
Basic material common stocks	5,939,182	-	-	5,939,182
Financial common stocks	6,697,647	-	-	6,697,647
Healthcare common stocks	11,345,242	-	-	11,345,242
Other common stocks and mutual funds	33,226,792	-	-	33,226,792
Corporate obligations	-	29,299,729	-	29,299,729
Municipal obligations	-	30,376,049	-	30,376,049
Other	593,335	-	-	593,335
Total	<u>\$ 262,510,312</u>	<u>\$ 59,675,778</u>	<u>\$ -</u>	<u>\$ 322,186,090</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, 2016. The estimated liability for claims is discounted using an interest rate of 2.36%.

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. All insurance coverage is written under long duration, participating insurance contracts. 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 generally 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 April 10, 2017, the date that the financial statements were available for issuance.

Recent Accounting Pronouncements—In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. The update requires revenue recognition to reflect the transfer of promised goods or services to customers and replaces existing revenue recognition guidance. The updated standard permits the use of either the retrospective or cumulative effect transition method. Insurance contracts do not fall within the scope of this ASU. The effective date of ASU 2014-09 is for annual reporting periods beginning after December 15, 2018. The Fund is currently evaluating the impact to the Fund's financial statements.

In May 2015, the FASB issued ASU 2015-09, Financial Services—Insurance: Disclosures About Short-Duration Contracts. ASU 2015-09 requires entities to provide additional disclosures about the liability for unpaid claims and claim adjustment expenses to increase the transparency of significant estimates. The guidance also requires entities to disclose information about significant changes in methodologies and assumptions used to calculate the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements. The effective date of this new guidance is for annual reporting periods beginning after December 15, 2016. The ASU has not yet been adopted by the Fund. The Fund is currently evaluating the impact to the Fund's financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10)—Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 revises the accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. The effective date of ASU 2016-01 is for annual reporting periods beginning after December 15, 2018. The Fund is currently evaluating the impact to the Fund’s financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 amends previous guidance on the impairment of financial instruments by adding an impairment model that allows an entity to recognize expected credit losses as an allowance rather than impairing as they are incurred. The new guidance is intended to reduce complexity of credit impairment models and result in a more timely recognition of expected credit losses. The effective date of ASU 2016-13 is for interim and annual reporting periods beginning after December 15, 2020. The ASU has not yet been adopted by the Fund. The Fund is currently evaluating the impact to the Fund’s financial statements.

3. INVESTMENTS

Investments as of December 31, 2016 and 2015, consist of the following:

	2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury notes and bonds	\$ 187,713,986	\$ 2,599,173	\$(2,074,337)	\$ 188,238,822
Domestic common stocks:				
Technology common stocks	7,023,010	5,166,542	-	12,189,552
Basic material common stocks	7,917,839	2,191,154	(65,834)	10,043,159
Financial common stocks	5,340,254	3,344,344	(24,921)	8,659,677
Healthcare common stocks	8,061,075	3,769,219	-	11,830,294
Other common stocks and mutual funds	20,360,025	15,458,353	(105,779)	35,712,599
Corporate obligations	34,798,856	200,955	(156,572)	34,843,239
Municipal obligations	25,495,864	1,776	(409,400)	25,088,240
Other	<u>400,000</u>	<u>4,409</u>	<u>-</u>	<u>404,409</u>
Total	<u>\$ 297,110,909</u>	<u>\$ 32,735,925</u>	<u>\$(2,836,843)</u>	<u>\$ 327,009,991</u>
	2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury notes and bonds	\$ 191,843,745	\$ 3,978,177	\$ (542,824)	\$ 195,279,098
Domestic common stocks:				
Technology common stocks	5,622,722	3,806,294	-	9,429,016
Basic material common stocks	5,214,861	1,178,567	(454,246)	5,939,182
Financial common stocks	4,585,757	2,189,638	(77,748)	6,697,647
Healthcare common stocks	7,733,151	3,626,377	(14,286)	11,345,242
Other common stocks and mutual funds	19,787,577	13,837,247	(398,032)	33,226,792
Corporate obligations	29,047,383	363,669	(111,323)	29,299,729
Municipal obligations	30,370,634	136,171	(130,756)	30,376,049
Other	<u>589,531</u>	<u>3,804</u>	<u>-</u>	<u>593,335</u>
Total	<u>\$ 294,795,361</u>	<u>\$ 29,119,944</u>	<u>\$(1,729,215)</u>	<u>\$ 322,186,090</u>

The components of net investment income as of December 31, 2016 and 2015, are presented below:

	2016	2015
Investment income:		
Interest on fixed income securities	\$ 6,205,778	\$ 6,125,543
Dividends on equity securities	1,734,001	1,657,264
Other investment income	29,254	10,654
Less investment expense	<u>(493,771)</u>	<u>(493,216)</u>
Net investment income	<u>\$ 7,475,262</u>	<u>\$ 7,300,245</u>

The components of net realized investment gains included in earnings as of December 31, 2016 and 2015, are as follows:

	2016	2015
Net realized investment gains:		
Fixed income:		
Gross realized gains	\$ 94,820	\$ 6,697
Gross realized losses	-	(269,569)
Equity securities:		
Gross realized gains	747,006	1,277,414
Gross realized losses	<u>(55,807)</u>	<u>(93,180)</u>
Net realized investment gains	<u>\$786,019</u>	<u>\$ 921,362</u>

Debt instruments held as of December 31, 2016, will mature as follows:

Maturing	Amortized Cost	Fair Value
Within 1 year	\$ 44,927,360	\$ 45,135,700
After 1 year through 5 years	142,037,416	144,018,736
After 5 years through 10 years	57,045,359	55,247,165
After 10 years	<u>3,998,571</u>	<u>3,768,700</u>
Total	<u>\$ 248,008,706</u>	<u>\$ 248,170,301</u>

In lieu of purchasing a bond, as required by the Kentucky Department of Insurance, the Fund has pledged approximately \$26,451,290 of investments, at fair value, as collateral for the payment of workers' compensation claims as of December 31, 2016. 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, 2016 and 2015:

	2016					
	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	\$ 61,356,584	\$(1,956,953)	\$ 10,183,768	\$(117,384)	\$ 71,540,352	\$(2,074,337)
Domestic common stocks:						
Basic material common stocks	1,043,180	(14,807)	1,064,684	(51,027)	2,107,864	(65,834)
Financial institutions common stocks	339,080	(24,921)	-	-	339,080	(24,921)
Other common stocks and mutual funds	1,911,562	(30,144)	696,710	(75,635)	2,608,272	(105,779)
Corporate obligations	7,984,380	(153,357)	5,504,415	(3,215)	13,488,795	(156,572)
Municipal obligations	<u>17,161,350</u>	<u>(334,777)</u>	<u>5,925,390</u>	<u>(74,623)</u>	<u>23,086,740</u>	<u>(409,400)</u>
Total	<u>\$ 89,796,136</u>	<u>\$(2,514,959)</u>	<u>\$ 23,374,967</u>	<u>\$(321,884)</u>	<u>\$ 113,171,103</u>	<u>\$(2,836,843)</u>

	2015					
	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	\$ 29,365,068	\$(234,036)	\$ 26,249,475	\$(308,788)	\$ 55,614,543	\$(542,824)
Domestic common stocks:						
Basic material common stocks	1,243,916	(84,025)	745,489	(370,221)	1,989,405	(454,246)
Financial institutions common stocks	1,110,780	(77,748)	-	-	1,110,780	(77,748)
Healthcare common stocks	2,638,310	(14,286)	-	-	2,638,310	(14,286)
Other common stocks and mutual funds	834,957	(183,647)	557,960	(214,385)	1,392,917	(398,032)
Corporate obligations	2,013,830	(3,442)	11,441,580	(107,881)	13,455,410	(111,323)
Municipal obligations	-	-	10,865,500	(130,756)	10,865,500	(130,756)
Total	<u>\$ 37,206,860</u>	<u>\$(597,184)</u>	<u>\$ 49,860,004</u>	<u>\$(1,132,031)</u>	<u>\$ 87,066,865</u>	<u>\$(1,729,215)</u>

At December 31, 2016, two municipal funds, four corporate bonds, four domestic common stocks and four U.S. treasury bonds with a total unrealized losses of \$74,623, \$3,215, \$126,662 and \$117,384, respectively, 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, 2016, 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, 2016 and 2015, aggregate excess insurance receivables with an undiscounted value of \$550,194 and \$641,116, respectively, were associated primarily with one excess insurer.

Specific excess insurance provides coverage for each loss in excess of certain amounts. At December 31, 2016 and 2015, specific excess insurance receivables with an undiscounted value of \$27,448,300 and \$28,583,312, 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, 2016 and 2015, is summarized as follows:

	2016	2015
Balance—January 1	\$ 254,769,183	\$ 245,426,158
Less excess insurance receivables	<u>26,505,773</u>	<u>21,370,580</u>
Net balance—January 1	<u>228,263,410</u>	<u>224,055,578</u>
Incurred related to:		
Current year—undiscounted	55,746,669	52,147,772
Decrease in prior years' estimates—undiscounted	<u>(11,296,822)</u>	<u>(12,081,080)</u>
Total incurred—undiscounted	44,449,847	40,066,692
Effect of discounting reserves	<u>(3,677,871)</u>	<u>(911,184)</u>
Net incurred	<u>40,771,976</u>	<u>39,155,508</u>
Paid related to:		
Current year	8,382,042	6,758,912
Prior years	<u>24,743,262</u>	<u>28,188,764</u>
Total paid	<u>33,125,304</u>	<u>34,947,676</u>
Net balance—December 31	235,910,082	228,263,410
Plus excess insurance receivables	<u>26,688,474</u>	<u>26,505,773</u>
Balance—December 31	<u>\$ 262,598,556</u>	<u>\$ 254,769,183</u>

At December 31, 2016 and 2015, estimated liabilities for claims of \$289,017,257 and \$277,692,713, respectively, net of excess insurance receivables, are presented above at their discounted net present value of \$235,910,082 and \$228,263,410, respectively.

As a result of changes in estimates of insured events in prior years, the claims and claim adjustment expenses decreased by \$11,296,822 in 2016, 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, 2016 and 2015, are as follows:

	2016	2015
Estimated liability for claims—gross of excess insurance receivables	\$ 262,598,556	\$ 254,769,183
Less excess and specific insurance receivables	<u>(26,688,474)</u>	<u>(26,505,773)</u>
Estimated liability for claims—net of excess insurance receivables	<u>\$ 235,910,082</u>	<u>\$ 228,263,410</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, 2016 and 2015.

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 \$585,217 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 primary difference between the statutory tax rate and the effective tax rate for the Fund is the dividends received deduction.

The tax effects of temporary differences, which give rise to the deferred taxes at December 31, 2016 and 2015, are as follows:

	2016	2015
Estimated liability for claims	\$ 1,336,435	\$ 1,685,787
Other	585,217	446,468
Net unrealized gain on investments	<u>(10,210,416)</u>	<u>(9,346,518)</u>
Net deferred tax liability	<u>\$ (8,288,764)</u>	<u>\$ (7,214,263)</u>

Income tax expense for the years ended December 31, 2016 and 2015, consist of the following:

	2016	2015
Current year expense	\$357,445	\$ 1,066,640
Deferred expense	<u>210,602</u>	<u>296,761</u>
Income tax expense	<u>\$568,047</u>	<u>\$ 1,363,401</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, 2016 and 2015, 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 2013.

7. RELATED PARTY TRANSACTIONS

Service fee expenses to Ladegast & Heffner Claims Service were \$8,638,104 and \$8,014,380, for the years ended December 31, 2016 and 2015, respectively. At December 31, 2016 and 2015, service fee liabilities of \$1,300,455 and \$1,274,406, respectively, were due to Ladegast & Heffner Claims Service. The service fee is based on a percentage of premiums earned and was 13.7% at 12/31/16 and 12/31/15.

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