

VLCT Unemployment Insurance Trust, Inc.

Audited Financial Statements  
with Supplementary Information

*Years ended December 31, 2012 and 2011  
with Report of Independent Auditors*

VLCT Unemployment Insurance Trust, Inc.

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with Supplementary Information

Years ended December 31, 2012 and 2011

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## Report of Independent Auditors

The Board of Directors  
VLCT Unemployment Insurance Trust, Inc.

We have audited the accompanying financial statements of VLCT Unemployment Insurance Trust, Inc. ("the Trust"), which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of VLCT Unemployment Insurance Trust, Inc. as of December 31, 2012 and 2011 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.

## **Other Matters**

### *Required Supplementary Information*

The accounting principles generally accepted in the United States require that the Management's Discussion and Analysis on pages 3 - 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audits were conducted for the purpose of forming an opinion on the Trust's basic audited financial statements. The other information on page 24 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The other information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Burlington, Vermont  
April 25, 2013

A handwritten signature in black ink that reads "Johnson Lambert LLP". The signature is written in a cursive, flowing style.

Vermont firm registration: 092-0000267

# VLCT Unemployment Insurance Trust, Inc.

## Management's Discussion and Analysis

Years ended December 31, 2012 and 2011

The management of VLCT Unemployment Insurance Trust, Inc. ("the Trust") presents the following overview and analysis of its financial operations for the fiscal year ended December 31, 2012, to be reviewed and considered in conjunction with the more detailed statements, schedules, exhibits and notes in the ensuing pages of this report.

### *Highlights*

- Assets exceeded liabilities in 2012 by \$1,943,199, with an increase in total assets of \$579,283 (35%) and a decrease in liabilities of \$43,909 (13%). Assets exceeded liabilities in 2011 by \$1,320,007, with total assets increasing by \$265,935 (19%) and liabilities decreasing by \$21,315 (6%). Operating surpluses for 2012 and 2011, combined with investment earnings, contributed to an increase in cash and investments of \$577,745 or 35% and \$270,185 or 20%, respectively, resulting in higher total assets. Year-end claim liabilities for both years were reduced due to improved unemployment claim numbers.
- Net position in 2012 increased by \$623,192 or 47% from 2011. This compares to an increase of \$287,250 or 28% experienced last year. The increase in 2012 was primarily the result of a decrease in claim payments of \$227,892 or 34% combined with an increase in contributions of \$39,307 or 4%.
- The ratio of net position to total assets increased from 80% in 2011 to 87% in 2012. This ratio measures the ability of the Trust to withstand unanticipated increases in claims that are not offset by contributions, as well as negative market performance during the year. The increase from 2011 to 2012 is due to a combination of underwriting to ensure contributions will cover future economic downturns, an improved economy resulting in fewer claims, and continued solid investment earnings.
- The Trust returned \$50,000 of contribution credits to the members during 2012. No rate credit was given in 2011 due to deficits projected during budget development in 2010. In 2012, the Board of Directors (the Board) approved a \$287,250 rate credit to be applied against 2013 contributions. This amount has been restricted in the statement of net position as of December 31, 2012.

## VLCT Unemployment Insurance Trust, Inc.

### Management's Discussion and Analysis (Continued)

#### *Overview of the Trust's Financial Statements*

The Trust's fiscal year is January 1 through December 31. All activities of the Trust are accounted for as enterprise fund. The Trust's operations primarily include determination and collection of appropriate member contributions, issuing claim benefit payments and paying administrative costs of operating the Trust. Administrative costs include direct costs from operating the Trust, as well as indirect or fixed costs that are incurred by Vermont League of Cities and Towns ("VLCT") and allocated to all three VLCT sponsored insurance trusts. Claims payments are made to claimants by the State of Vermont Department of Labor, with TALX Corporation contracted to administer and report claims. The Trust reimburses the State of Vermont for these payments on a quarterly basis.

The annual financial report consists of three parts:

- Management's Discussion and Analysis
- Financial Statements and Disclosures
- Supplementary Schedule of Revenues and Expenses - Budgetary Basis

Management's discussion and analysis provides a narrative overview of the statements and comments on significant developments during the reporting period. The intention is to present a financial summary of operations for the past fiscal year and discuss the outlook for the ensuing year.

Required financial statements include:

- Statements of Net Position
- Statements of Revenues, Expenses and Changes in Net Position
- Statements of Cash Flows
- Notes to the Financial Statements

These statements present the Trust's status at December 31, 2012 and 2011 and financial developments during 2012 and 2011 for all activities. Comparative data for the prior year is included in the exhibits and notes to the financial statements.

The statements of net position present the economic position of the Trust as of December 31, 2012 and 2011, showing the assets owned by the Trust and how those assets are financed: by debt or short-term obligations, and by net position (the Trust's equity), more commonly known as the "net assets" prior to the implementation of GASB 63 reporting requirements, or "surplus" as it is referred to in the insurance industry.

## VLCT Unemployment Insurance Trust, Inc.

### Management's Discussion and Analysis (Continued)

#### *Overview of the Trust's Financial Statements- Continued*

The statements of revenue, expenses and changes in net position show the operating transactions for the year, revenue and expenses. The result of operations is the change in net position. This figure added to last fiscal year's net position is the new net position total shown in both the statements of net position as well as the statements of revenue, expenses and changes in net position.

The statements of cash flows outline the cash flow resulting from operations, investment, and financing activities of the Trust.

Notes to the financial statements provide explanations of the accounting principles followed and of key items in the statements. They include tables showing detailed analysis of certain accounts.

The supplementary schedule of revenues and expenses - budgetary basis for the year ended December 31, 2012 is presented for the purposes of additional analysis and is not a required part of the basic financial statements.

Please note that in the following analysis, when ratios are discussed, insurance terms are used along with the standard accounting terms. "Surplus" is used in the insurance industry for the accounting term "net position", and "premium" is used for "contributions". Accounting and insurance terms may be used interchangeably in the following sections when discussing ratios.

#### *Results and Analysis*

The following table summarizes the statements of net position:

	<u>December 31, 2012</u>	<u>December 31, 2011</u>	<u>Percentage Change</u>	<u>December 31, 2010</u>	<u>Percentage Change</u>
<b>Assets</b>					
Cash and Investments	\$ 2,212,566	\$ 1,634,821	35.3 %	\$ 1,364,636	19.8 %
Other assets	<u>22,053</u>	<u>20,515</u>	7.5 %	<u>24,765</u>	(17.2)%
Total assets	\$ 2,234,619	\$ 1,655,336	35.0 %	\$ 1,389,401	19.1 %
<b>Liabilities</b>					
Total liabilities	<u>\$ 291,420</u>	<u>\$ 335,329</u>	(13.1)%	<u>\$ 356,644</u>	(6.0)%
<b>Net Position</b>					
Restricted	287,250	50,000	474.5 %	-	100.0 %
Unrestricted	<u>1,655,949</u>	<u>1,270,007</u>	30.4 %	<u>1,032,757</u>	23.0 %
Total net position	<u>\$ 1,943,199</u>	<u>\$ 1,320,007</u>	47.2 %	<u>\$ 1,032,757</u>	27.8 %

## VLCT Unemployment Insurance Trust, Inc.

### Management's Discussion and Analysis (Continued)

#### *Results and Analysis - Continued*

As of December 31, 2012, total assets increased by 35.0% from \$1,655,336 to \$2,234,619, compared to an increase of 19.1% from 2010 to 2011. This is due to a 3.9% increase in contributions and a 34.0% decrease in overall claims. A rate increase for 2012 coupled with an increase in the taxable wage base from \$13,000 in 2011 to \$16,000 in 2012 resulted in an overall increase in contributions of \$39,307. Of the total earnings for 2012, \$73,966 was in market gains, of which about 54.0% was in realized gains. This compares with a 2011 market gain of \$19,076 of which about 42.7% was realized gains.

As of December 31, 2012, total current liabilities decreased by 13.1% from \$335,329 to \$291,420 compared with a decrease of 6.0% from 2010 to 2011. This decrease of \$43,909 in 2012 is primarily due to reduction in fourth quarter claims, recorded as a payable to the Vermont Department of Labor. In addition to claims, contributions paid in advance for the ensuing year, recorded as unearned income, decreased from 2011 to 2012. These receipts for contributions paid in advance will not be recognized as revenue until 2013 and are therefore classified as a liability at December 31, 2012.

Net position increased in 2012 by 47.2% or \$623,192 from 2011. This compares to an increase of \$287,250 or 27.8% in 2011 from 2010. The increase in 2012 was primarily the result of a decrease in claim payments of \$227,892 or 34.0% combined with an increase in contributions of \$39,307 or 3.9%. In 2011 claim payments decreased only \$81,581 or 10.9%, with contributions increasing by \$164,577 or 19.4%.

As can be seen in the following chart, net position or surplus as a ratio to total assets has been impacted by the recent recession but has seen improvement over the past four years. A higher ratio is preferable because it provides more of a cushion against unexpected losses, poor investment returns, or revenue shortfalls from insufficient contributions to cover benefit payments. In addition, benefit or duration changes that occur as a result of legislative actions could significantly impact this ratio.

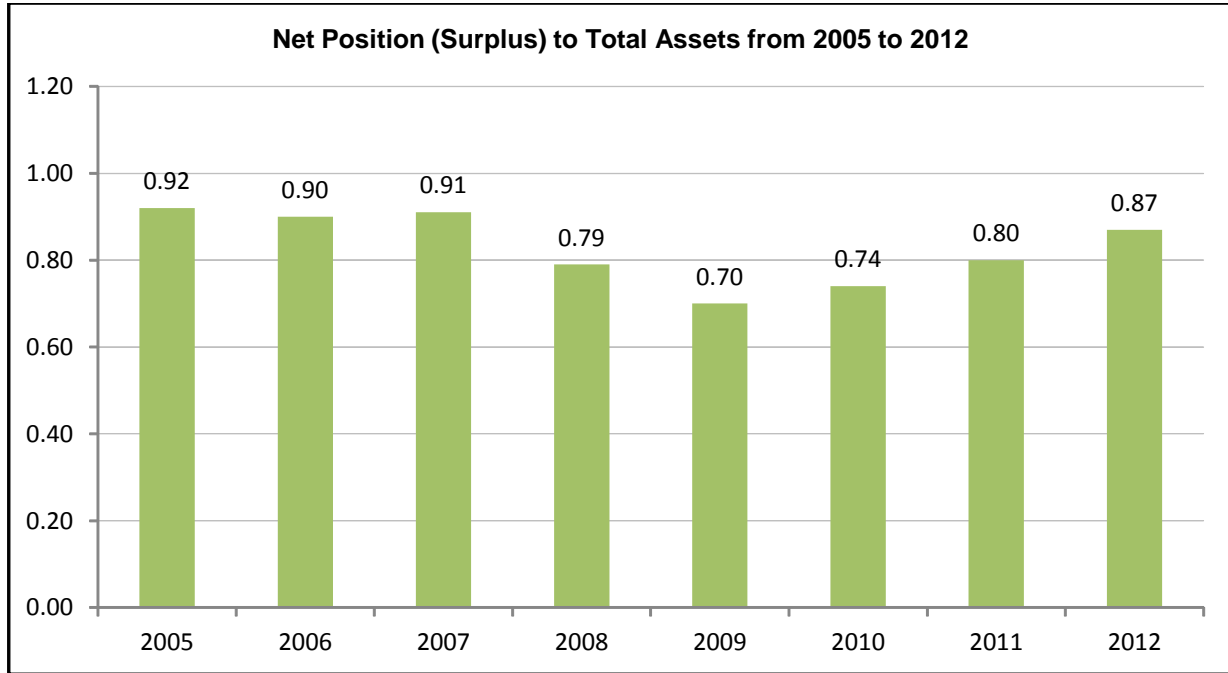
Because the Trust is fully self-insured and has no reinsurance to fall back on, a positive net position amount is particularly important for financial stability as shown by the trend leading up to the 2008 recession in the chart below. Though the Trust's ratio was over 90% in 2007, the large increase in claims combined with lower investment income resulting from the economic downturn depleted the Trust's net position significantly. Without that "reserve" from a substantial net position, the resulting hit on the Trust could have been catastrophic, resulting in some very significant rate increases to recoup the losses. With strong operating and investment performance in 2011 and 2012, the Trust has made some significant gains in getting back to that position of strength, moving much closer to the pre-recession levels.



VLCT Unemployment Insurance Trust, Inc.

Management's Discussion and Analysis (Continued)

*Results and Analysis - Continued*



## VLCT Unemployment Insurance Trust, Inc.

### Management's Discussion and Analysis (Continued)

#### ***Results and Analysis - Continued***

The following table summarizes the statements of revenues, expenses and changes in net position:

	December 31, 2012	December 31, 2011	Percentage Change	December 31, 2010	Percentage Change
<b>Operating Revenues</b>					
Fund contributions	\$ 1,052,436	\$ 1,013,129	3.9 %	\$ 848,552	19.4 %
Management fees	<u>52,243</u>	<u>52,000</u>	0.5 %	<u>52,000</u>	-
Total operating revenues	1,104,679	1,065,129	3.7 %	900,552	18.3 %
<b>Operating Expenses</b>					
Claims benefit payments	442,123	670,015	(34.0)%	751,596	(10.9)%
Operating expenses	<u>152,110</u>	<u>164,719</u>	(7.7)%	<u>156,768</u>	5.1 %
Total operating expenses	<u>594,233</u>	<u>834,734</u>	(28.8)%	<u>908,364</u>	(8.1)%
Operating income (loss)	<u>510,446</u>	<u>230,395</u>	121.6 %	<u>(7,812)</u>	(3,049.2)%
<b>Non-Operating Revenues</b>					
Investment income, net of fees	<u>112,746</u>	<u>56,855</u>	98.3 %	<u>101,062</u>	(43.7)%
Change in net position	623,192	287,250	117.0 %	93,250	208.0 %
Net Position, Beginning of Year	<u>1,320,007</u>	<u>1,032,757</u>	27.8 %	<u>939,507</u>	9.9 %
Net Position, End of Year	<u>\$ 1,943,199</u>	<u>\$ 1,320,007</u>	47.2 %	<u>\$ 1,032,757</u>	27.8 %

The Trust had an operating income of \$510,446 in 2012 compared with an operating income of \$230,395 for 2011 and a \$7,812 operating loss in 2010. The combination of the \$39,307 increase in contributions and a \$227,892 decrease in claims expenses resulted in this positive performance in 2012. In 2011, contributions were also more than sufficient to fully cover claims and administrative expenses, improving operations with a rate increase intended to cover the higher level of claims after the \$7,812 operating loss in 2010. Contributions in 2011 increased by \$164,577 and claims payments decreased by \$81,581.

The increase in contributions for 2012 reflected a rate increase of 1.9% that was intended to cover 2012 projected claims based on 2011 benefits. In addition to the overall rate increase, the taxable wage base increased from \$13,000 to \$16,000. Rate credits of \$50,000 and \$287,250 were recommended and approved by the Board for 2012 and 2013, respectively.

Claim benefit payments decreased with the improved economy. Contributions anticipated worst case benefit disbursements and as unemployment decreased, payments did as well, resulting in a 34.0% drop in claims benefit payments from 2011 to 2012.

## VLCT Unemployment Insurance Trust, Inc.

### Management's Discussion and Analysis (Continued)

#### *Results and Analysis - Continued*

Operating expenses for the year decreased from 2011 by \$12,609 or 7.7%, primarily due to a reduction in VLCT Administration costs which ended the year below budget by 11.3% after the final true-up. VLCT's decision not to relocate its office resulted in savings that were allocated back to all three trusts. The total savings to the Trust over 2011 was \$8,708 or 69% of the total decrease in operating expenses.

Net investment earnings for 2012 were \$112,746 compared with net investment earnings of \$56,855 in 2011. Out of this total, there was a net increase in the fair value of investments (net realized and net unrealized) of \$73,966 in 2012 compared with \$19,076 in 2011. The balance of the year to year change in net investment earnings for both years is in interest and dividends earned. The market and economic conditions were the drivers of this increase in earnings from 2011 to 2012.

The asset allocation at the end of 2012 is comprised of 28.6% equities, 69.2% fixed income, and 2.2% cash equivalents. This compares with 27.0% equities, 70.0% fixed income, and 3.0% cash equivalents at the end of 2011, and with 29.0% equities, 67.3% fixed income, and 3.7% cash equivalents at the end of 2010. Weighted returns at year end 2012 were 6.76% for the fixed income portfolio (compared with the Barclays Capital Aggregate market index of 4.82%), while the equity portfolio showed weighted returns of 15.64% (compared with the Russell 3000 market index of 16.68%). Although equities did not perform well against the benchmark as measured over the year, an analysis of both three and five-year periods show them outperforming both benchmarks.

Net investment earnings of \$112,746 added to operating surplus of \$510,446 results in the change in net position of \$623,192 for 2012.

VLCT Unemployment Insurance Trust, Inc.

Management's Discussion and Analysis (Continued)

**Results and Analysis - Continued**

The following table summarizes budgeted revenues and expenses versus actual results, showing the variance from budgeted for the year ended December 31, 2012:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
<b>Operating Revenues</b>			
Fund contributions	\$ 1,102,442	\$ 1,052,436	\$ (50,006)
Management fees	<u>52,243</u>	<u>52,243</u>	<u>-</u>
Total operating revenues	1,154,685	1,104,679	(50,006)
<b>Operating Expenses</b>			
Claims benefit payments	961,688	442,123	519,565
Operating expenses - all cost centers	<u>174,000</u>	<u>152,110</u>	<u>21,890</u>
Total operating expenses	<u>1,135,688</u>	<u>594,233</u>	<u>541,455</u>
Operating excess of revenues over expenditures	18,997	510,446	491,449
Non-operating - investment income (loss)	<u>(3,500)</u>	<u>112,746</u>	<u>116,246</u>
Excess of Revenues Over Expenditures	<u>\$ 15,497</u>	<u>\$ 623,192</u>	<u>\$ 607,695</u>

As shown in this budget analysis, the operating surplus of \$510,446 was significantly more than the budgeted operating income of \$18,997. The variance in actual operating surplus to budget is attributable to claim benefit payments being \$519,565 less than budgeted and operating expenses below the budgeted amount by \$21,890.

On the revenue side, contributions were under budget by \$50,006, which was the rate credit that was approved for 2012. The budget is shown gross of that credit, which reduces prior year surplus.

Actual investment earnings (of which only investment fees are budgeted) produced net investment income of \$112,746, increasing the overall variance over budget to \$607,695.

To determine member contributions or premiums, the Trust has used a retrospective rate-setting approach, budgeting for the worst case and paying back to members the difference between the actual and budgeted amounts, along with any investment income earned on the surplus funds. Both the budget for the ensuing year and distributions from prior year claims activity are based on an actuarial rate study completed annually. A \$50,000 distribution was made to members in 2012. No distributions were made to members in 2011 due to projected deficits during budget development in 2010.

## VLCT Unemployment Insurance Trust, Inc.

### Management's Discussion and Analysis (Continued)

#### *Results and Analysis - Continued*

Claims benefit payments were budgeted based on a maximum benefit ratio calculated from trend data for the period 1999 to 2011 (with 2011 projected), and applied to the 2011 taxable wage base of \$57.7 million. The last three years, 2009 through 2011, trended high with 2009 being the worst benefit payout year at a 1.49% benefit ratio (2010 and 2011 were 1.34% and 1.17%, respectively). Actual benefit payments for every quarter in 2012 were lower than in the prior year, starting at 29.8% less for the first quarter and ending the year 34.0% lower.

Administrative operating expenses were lower than budgeted in 2012 primarily due to a decrease in VLCT Administration costs which ended the year below budget as indicated earlier. The savings to the Trust for VLCT Administration costs as compared to budget was \$11,075, which is 50.6% of the total amount of operating costs below budget.

Additional significant variances to note within the individual budgets for operating expenses include:

- Actuarial costs were below budget by \$977 or 17.8%. Last year's cost reflected additional work that was done to determine a 75% confidence level scenario as well as review work for both the wage database project and the revision to the member participation agreement.
- Legal services were lower than anticipated by \$1,428 or 28.6% due to a combination of diligent follow-ups after the initial claim filings and improved economic conditions.
- Board travel costs were below budget by \$1,443 or 48.1% reflecting lower participation in conferences.
- Insurance costs were in line with prior year but were 56.0% or \$1,847 under budget. The budget was set using prior years' data and the formula for allocating costs was changed to more accurately reflect exposures, reducing the actual allocation to the Trust in 2012.
- Bank fees were below budget by \$690 or 36.3% due primarily to lower fees from changes in programs.
- Administration staff travel costs were higher than budget by \$1,527 or 89.8% due to the unanticipated participation in a conference held by our third party administrator. This was not budgeted but was considered an essential training.
- Overall costs of the Member Relations cost center were under-spent by \$3,013 or 25.5%. All Member Relations activities have very small budgets, and with a stable membership, there is less need for heavier marketing efforts.

## VLCT Unemployment Insurance Trust, Inc.

### Management's Discussion and Analysis (Continued)

#### ***Outlook and Economic Factors***

Unemployment rates in Vermont continue to be below 6%. The U.S. economic recovery continues and the Trust has benefited from this improvement. The Trust has again seen its claims drop year over year. This trend of stable or dropping claims began in the second quarter of 2010.

As a result of continuing positive results, the Trust's rates for 2013 were renewed on a flat, as per expiring basis.

The chart below illustrates the average rate and estimated taxable wages for the current and previous three years:

<b>Year</b>	<b>Average Rate</b>	<b>Trust Taxable Wages*</b>
2013	1.90%	\$60.0 million
2012	1.90%	\$57.7 million
2011	2.18%	\$46.6 million
2010	2.15%	\$39.6 million

\*Although there may have been some real growth in payroll, it is important to note that the taxable wage base increased from \$8,000 to \$16,000 during this period.

The 2013 actuarial study projected a net gain for the Trust and recommended granting a contribution rate credit. The Board voted to provide a contribution rate credit in the amount of \$287,250, which is a substantial increase over the 2012 contribution rate credit of \$50,000.

Claims have stabilized and are still dropping from their 2009-2010 highs, meaning our rates should be adequate to cover claims in 2013. This should allow the Trust to continue to maintain a strong net position to meet its obligations going forward.

#### ***Requests for Information***

This financial report is designed to provide a general overview of VLCT Unemployment Insurance Trust, Inc.'s finances for all those with an interest in the Trust's finances. Questions concerning any of the information provided in this report or requests for financial information should be addressed to the Chief Financial Officer at the Vermont League of Cities and Towns, 89 Main Street, Suite 4, Montpelier, Vermont, 05602-2948, or by calling 802-229-9111.

VLCT Unemployment Insurance Trust, Inc.

Statements of Net Position

	As of December 31,	
	<u>2012</u>	<u>2011</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 940,791	\$ 486,348
Investments, at fair value	899,914	828,985
Mutual funds, at fair value	371,861	319,488
Accrued investment income	8,211	9,657
Prepaid expenses	2,835	1,317
Due from VLCT	<u>11,007</u>	<u>9,541</u>
 Total Assets	 <u>\$ 2,234,619</u>	 <u>\$ 1,655,336</u>
 <b>Liabilities and Net Position</b>		
<b>Liabilities</b>		
Due to Vermont Department of Labor	\$ 113,158	\$ 153,408
Unearned income	166,792	172,371
Accounts payable	<u>11,470</u>	<u>9,550</u>
Total liabilities	291,420	335,329
 <b>Net Position</b>		
Restricted	287,250	50,000
Unrestricted	<u>1,655,949</u>	<u>1,270,007</u>
Total net position	<u>1,943,199</u>	<u>1,320,007</u>
 Total Liabilities and Net Position	 <u>\$ 2,234,619</u>	 <u>\$ 1,655,336</u>

*See accompanying notes to the financial statements.*

VLCT Unemployment Insurance Trust, Inc.

Statements of Revenues, Expenses, and Changes in Net Position

	Years ended December 31,	
	2012	2011
<b>Operating Revenues</b>		
Member contributions	\$ 1,052,436	\$ 1,013,129
Management fees	52,243	52,000
Total operating revenues	1,104,679	1,065,129
 <b>Operating Expenses</b>		
Claims benefit payments	442,123	670,015
General and administrative expenses	152,110	164,719
Total operating expenses	594,233	834,734
 Net operating income	510,446	230,395
 <b>Non-Operating Revenues (Expenses)</b>		
Investment income	42,165	40,806
Investment income - net realized gains and change in fair value	73,966	19,076
Investment management fees	(2,282)	(2,100)
Investment consulting fees	(1,103)	(927)
 Net non-operating revenues	112,746	56,855
 Change in Net Position	623,192	287,250
 Net Position, Beginning of Year	1,320,007	1,032,757
 Net Position, End of Year	\$ 1,943,199	\$ 1,320,007

*See accompanying notes to the financial statements.*



VLCT Unemployment Insurance Trust, Inc.

Statements of Cash Flows

	Years ended December 31,	
	<u>2012</u>	<u>2011</u>
<b>Cash Flows from Operating Activities</b>		
Receipts for member contributions	\$ 1,046,857	\$ 1,005,487
Receipts for management fees	52,243	52,000
Payments for claims	(482,373)	(692,520)
Payments for general and administrative expenses	<u>(153,174)</u>	<u>(151,244)</u>
Net cash provided by operating activities	463,553	213,723
<b>Cash Flows from Investing Activities</b>		
Receipts of interest income	43,611	40,413
Investment management fees	(2,282)	(2,100)
Investment consulting fees	(1,103)	(927)
Purchases of investments	(778,294)	(513,805)
Proceeds of investments	<u>728,958</u>	<u>468,009</u>
Net cash used in investing activities	(9,110)	(8,410)
Net Change in Cash and Cash Equivalents	454,443	205,313
Cash and Cash Equivalents, Beginning of Year	<u>486,348</u>	<u>281,035</u>
Cash and Cash Equivalents, End of Year	<u>\$ 940,791</u>	<u>\$ 486,348</u>
<b>Reconciliation of Operating Income to Net Cash Provided By Operating Activities</b>		
Net operating income	\$ 510,446	\$ 230,395
Changes in assets and liabilities:		
Prepaid expenses	(1,518)	234
Due from VLCT	(1,466)	4,409
Due to Vermont Department of Labor	(40,250)	(22,505)
Unearned income	(5,579)	(7,642)
Accounts payable	<u>1,920</u>	<u>8,832</u>
Net cash provided by operating activities	<u>\$ 463,553</u>	<u>\$ 213,723</u>

*See accompanying notes to the financial statements.*

# VLCT Unemployment Insurance Trust, Inc.

## Notes to the Financial Statements

Years ended December 31, 2012 and 2011

### **Note A - Organization and Nature of Operations**

#### *Organization*

VLCT Unemployment Insurance Trust, Inc. ("the Trust") was incorporated in 1978 to provide Vermont municipalities with a stable, cost effective means to maintain their unemployment costs at the lowest possible levels. Services performed by the Trust include (1) pay costs due to unemployment claims filed against the municipality; (2) a professional claims management system to review and monitor all data and reports upon filing for unemployment compensation; (3) legal and administrative representation at hearings and appeals before the Vermont Department of Labor up through the Vermont Supreme Court; (4) information on current legislation and representation before the Vermont legislature on all unemployment matters affecting Vermont municipalities; (5) effective cost-control programs on all aspects of the unemployment compensation law and how it affects cities and towns; and (6) an affiliation with the Vermont League of Cities and Towns ("VLCT"), an organization dedicated to the betterment of Vermont local government.

The Trust had 211 and 210 members as of December 31, 2012 and 2011.

### **Note B - Summary of Significant Accounting Policies**

#### *Basis of Accounting*

The financial statements of the Trust have been prepared using the accrual basis of accounting in conformity with accounting principles generally accepted in the United States ("GAAP") as applied to governmental entities. In accordance with Government Accounting Standards Board ("GASB") Statement No. 62 *Codification of Accounting and Financial Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* ("Statement No. 62"), the Trust follows all applicable GASB guidance. The Trust uses the economic resources measurement focus and the accrual basis of accounting and is accounted for as a proprietary enterprise fund.

#### *Risks and Uncertainties*

The Trust's operating results and financial condition are affected by numerous factors and circumstances inherent within the insurance industry, some of which it can neither predict nor control. Among them are (1) the state of the economy and the associated unemployment levels which impact claims benefit payments; (2) fluctuations in interest rates affect the value and income yield of the Trust's investment portfolio in the short-term, and often affect default and prepayment rates over time; (3) legislation that might impact benefit payments or duration of benefits. Should any of these or similar events occur, the Trust's operating results and financial condition may be affected.

## VLCT Unemployment Insurance Trust, Inc.

### Notes to the Financial Statements (Continued)

#### **Note B - Summary of Significant Accounting Policies (Continued)**

##### *Subsequent Events*

The Trust has evaluated subsequent events for disclosure and recognition through April 25, 2013, the date on which these financial statements were available to be issued.

##### *Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

The Trust engages an independent actuary to estimate a target net position to protect against potential future financial losses. The Trust does not record a liability for future claims and claims handling expenses due to the nature of the contracted relationship between the Trust and its members, and the claims paid nature of the Participation and Indemnification Agreement ("the Agreement") signed by each member upon joining the Trust. The Trust is only responsible for the claims of its current members, as outlined by the Agreement. As more fully described in Note E, the target net position protects against potential financial losses in the event of inadequate rates charged to members due to unexpectedly high claims and/or negative investment income.

##### *Due to Vermont Department of Labor*

The Vermont Department of Labor pays claims benefits when incurred and is reimbursed by the Trust on a quarterly basis, a quarter in arrears. Claims benefits payable for claims incurred in the last quarter of December 31, 2012 and 2011 are classified as Due to Vermont Department of Labor on the statements of net position.

##### *Investments*

The Trust accounts for its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* ("Statement No. 31"). Statement No. 31 establishes fair value standards on accounting for all investments held by governmental external investment pools and governmental entities. All investment income, including changes in the fair value of investments, is recognized in the statements of revenues, expenses and changes in net position. Realized gains and losses on the sale of investments are recognized on the specific identification basis to determine the costs of the investments sold. The calculation of realized gains and losses is independent of the calculation of the net change in fair value of investments. Realized gains and losses on investments that had been held for more than one year and sold in the current year were included as a change in the fair value of investments reported in the prior years and the current year. Investment purchases are recognized on the trade date. Investments are stated at fair value based on quoted market prices or prices obtained from a recognized pricing service.

VLCT Unemployment Insurance Trust, Inc.

Notes to the Financial Statements (Continued)

**Note B - Summary of Significant Accounting Policies (Continued)**

*Cash and Cash Equivalents*

The Trust's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date acquired by the Trust.

The Trust's carrying amount of cash deposits and the bank balance at December 31, 2012 and 2011 were as follows:

	<u>December 31, 2012</u>		<u>December 31, 2011</u>	
	<u>Book</u>	<u>Bank</u>	<u>Book</u>	<u>Bank</u>
	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>
Insured/FDIC	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000
Uninsured, Collateralized by US Gov't and Agency Securities held by the People's United Bank Trust Department with a security interest granted to the Trust	<u>690,791</u>	<u>696,085</u>	<u>236,348</u>	<u>236,371</u>
Total	<u>\$ 940,791</u>	<u>\$ 946,085</u>	<u>\$ 486,348</u>	<u>\$ 486,371</u>

The difference between the book balance and the bank balance is due to reconciling items such as deposits in transit and outstanding checks.

The Federal Depository Insurance Corporation ("FDIC") insures amounts on deposit up to the limits as prescribed by the law. The Trust holds funds with financial institutions in excess of the FDIC insured amount, however, the Trust has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk on cash and cash equivalents. The Trust's deposits with People's United Bank are fully collateralized.

*Prepaid Expenses*

Payments for errors & omissions and professional liability insurance and subscriptions relating to the unexpired portion of the insurance agreements and the unused portion of subscriptions are recorded as prepaid expenses.

*Member Contributions*

The Trust bills member contributions based on the members' reported taxable payroll from prior periods limited to \$16,000 (\$13,000 in 2011) per employee multiplied by a rate established by the Board of Directors ("the Board"). Underwriting and rate-setting methods and policies are established and applied after consultation with an independent actuary.

## VLCT Unemployment Insurance Trust, Inc.

### Notes to the Financial Statements (Continued)

#### **Note B - Summary of Significant Accounting Policies (Continued)**

##### *Unearned Income*

Unearned income represents the amounts billed and collected at December 31, 2012 and 2011 for member contributions with coverage effective dates of January 1, 2013 and January 1, 2012, respectively.

##### *Income Taxes*

The Trust is incorporated as a nonprofit corporation under the Vermont Nonprofit Corporation Act. The Trust's income is tax-exempt under Internal Revenue Code Section 115, which pertains to political subdivisions. Accordingly, the accompanying financial statements do not include a provision for federal or state income taxes.

##### *Classification of Revenues and Expenses*

The Trust reports itself as a business-type activity as defined in GASB 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. Business-type activities are financed in whole or in part by fees charged to external parties. Business-type activities distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Trust's enterprise fund include fund contributions and fees received from providing services. Operating expenses include claims paid and the costs of providing services and operating all programs. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

#### **Note C - Investments**

The Trust's investment policy, as approved by the Board, contains certain provisions and limitations intended to mitigate the Trust's exposure to various investment risks, such as credit risk (including custodial risk and concentration risk) and interest rate risk, as follows:

- *Credit risk* - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit risk is measured by an assigned rating from a nationally recognized credit rating agency such as Standard and Poor's or Moody's Rating Services. These organizations look at a number of factors in order to evaluate the credit risk of an obligation and rate the risk. This rating allows investors to make informed buying and selling decisions. The Trust's investment policy is structured with limitations and guidelines intended to mitigate the components of credit risk as summarized in the following three bullet points.

VLCT Unemployment Insurance Trust, Inc.

Notes to the Financial Statements (Continued)

**Note C - Investments (Continued)**

- *Concentration of credit risk* - Concentration risk is the risk of loss attributable to the magnitude of an investment in a single issuer (with the exception of U.S. Government Obligations, which have no limit) to 5% of total investments. There are no single investments other than U.S. Government Obligations that exceed the limit as of December 31, 2012 and 2011.
- *Custodial credit risk* - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Trust will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Neither the Vermont Statutes nor the Trust's investment policy guidelines contain requirements limiting custodial credit risk other than indicating that "prudent investment policies" should be followed. An agreement with People's United Bank, the custodial financial institution for the investment portfolio, is in place and indemnifies the Trust against losses caused by negligence or dishonesty.
- *Interest rate risk* - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in interest rates. The Trust's investment policy limits the average effective duration to 8 years.

The following table provides a summary of the fair value of the Trust's investment portfolio by contractual maturity. The expected maturities in the following table may differ from the contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalty.

	December 31, 2012				Total
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	
U.S. Treasuries	\$ 75,315	\$ 125,221	\$ 28,247	\$ 35,261	\$ 264,044
U.S. Agencies	-	-	-	99,984	99,984
U.S. Agency MBS	7,027	4,687	58,474	2,315	72,503
Corporate Bonds	12,544	65,903	122,987	239,302	440,736
Municipal Bonds	-	-	-	22,647	22,647
<b>Total</b>	<b>\$ 94,886</b>	<b>\$ 195,811</b>	<b>\$ 209,708</b>	<b>\$ 399,509</b>	<b>\$ 899,914</b>

VLCT Unemployment Insurance Trust, Inc.

Notes to the Financial Statements (Continued)

**Note C - Investments (Continued)**

The table below outlines the Standard and Poor's credit ratings of the Trust's investment holdings as of December 31, 2012:

	U.S. <u>Treasuries</u>	U.S. <u>Agencies</u>	U.S. <u>Agency MBS</u>	Corporate <u>Bonds</u>	Municipal <u>Bonds</u>	<u>Total</u>
AAA	\$ -	\$ 28,589	\$ -	\$ 78,268	\$ -	\$ 106,857
AA+	264,044	-	72,503	18,762	-	355,309
AA	-	-	-	-	16,758	16,758
AA-	-	-	-	11,986	-	11,986
A+	-	-	-	25,085	-	25,085
A	-	-	-	61,530	5,889	67,419
A-	-	-	-	96,624	-	96,624
BBB+	-	-	-	96,344	-	96,344
BBB	-	-	-	22,493	-	22,493
Not Rated	-	71,395	-	29,644	-	101,039
<b>Total</b>	<b><u>\$ 264,044</u></b>	<b><u>\$ 99,984</u></b>	<b><u>\$ 72,503</u></b>	<b><u>\$ 440,736</u></b>	<b><u>\$ 22,647</u></b>	<b><u>\$ 899,914</u></b>

The effective duration is used to assess interest rate risk by estimating the sensitivity of fixed income securities to interest rate changes. The effective duration estimates the percentage change in the market value of an investment (or an investment portfolio) for a one percent change in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows for investments that are highly sensitive to interest rate changes, such as mortgage-backed securities, callable bonds, and variable-rate debt.

The following were the effective durations of investments held by the Trust as of December 31, 2012:

	<u>Fair Value</u>	<u>Effective Duration</u>
U.S. Treasuries	\$ 264,044	4.76
U.S. Agencies	99,984	4.43
U.S. Agency MBS	72,503	3.37
Corporate Bonds	440,736	8.25
Municipal Bonds	<u>22,647</u>	15.90
<b>Total</b>	<b><u>\$ 899,914</u></b>	<b>5.87</b>

The average effective duration of the investment portfolio as of December 31, 2012 and 2011, was 5.87 and 5.85 years, respectively.

## VLCT Unemployment Insurance Trust, Inc.

### Notes to the Financial Statements (Continued)

#### Note C - Investments (Continued)

The following table shows the classifications of the Fund's mutual fund investments as of December 31, 2012 and 2011:

<u>Classification</u>	<u>2012 Fair Value</u>	<u>2011 Fair Value</u>
Large Cap Blend	\$ 62,211	\$ 51,471
Large Cap Growth	57,797	47,155
Large Cap Value	62,625	54,593
Mid Cap Growth	58,971	51,768
Mid Cap Value	64,581	56,974
Small Cap Blend	<u>65,676</u>	<u>57,527</u>
Total	<u>\$ 371,861</u>	<u>\$ 319,488</u>

Net realized gains on the sale of investments were \$39,933 and net unrealized gains attributable to the change in fair value of investments were \$34,033 for the year ended December 31, 2012. Net realized gains on the sale of investments were \$8,153 and net unrealized gains attributable to the change in fair value of investments were \$10,923 for the year ended December 31, 2011.

#### Note D - Administrative Services Provided by VLCT

The accompanying financial statements represent the general operations of the Trust and do not include the operations and financial condition of VLCT or other affiliated organizations.

VLCT provides staff, office space and equipment usage to the Trust. The following VLCT expenses are attributable to the Trust.

- Salary and benefits for administrative staff including finance, human resource, production and general administrative support
- Office costs including all building-related expenses and insurances
- Equipment and communications costs
- Printing and supplies
- Travel and training for administrative functions
- Non-Trust Officers costs
- Contracted services
- Dues and subscriptions for administrative staff
- Services provided for administrative activities
- Miscellaneous costs related to administrative activities



VLCT Unemployment Insurance Trust, Inc.

Notes to the Financial Statements (Continued)

**Note D - Administrative Services Provided by VLCT (Continued)**

For the years ended December 31, 2012 and 2011, expenses allocated to the Trust were \$86,625 and \$95,333, respectively. These costs are included as a component of general and administrative expenses on the statements of revenues, expenses and changes in net position.

**Note E - Net Position**

As discussed in Note B, the Trust does not record a liability for future claims due to the claims paid nature of unemployment insurance and the Agreement with its members. Therefore beginning in 2010, the Board decided to no longer declare a portion of net position as designated for future claims liabilities.

As of December 31, 2012, the Trust has established a target net position of \$1,315,260 based on an actuarial assessment of variability of net income. The target net position represents a 99.9% confidence level as of December 31, 2012. The purpose of the net position target is to protect against potential financial losses in the event of unexpected high claims and/or possible poor investment returns. The net position target will be adjusted each year to reflect the most recent financial results. As of December 31, 2011, the Trust established a target net position of \$1,060,325.

The Trust budgets on a retrospective basis, giving back to members known surpluses in order to reduce future rates based on an actuarial assessment. The Trust returned \$50,000 of contribution credits to the members during the year ended December 31, 2012. The Trust elected not to return any surplus to members for the year ended December 31, 2011. During 2012, the Board also approved \$287,250 of contribution credits to be allocated to individual members upon renewal in 2013. Contribution credits approved by the Board for distribution during the following renewal year are recorded as restricted on the statements of net position.

VLCT Unemployment Insurance Trust, Inc.

Schedule of Revenues and Expenses - Budgetary Basis

December 31, 2012

(Unaudited)

	Budget	Actual	Variance Favorable / (Unfavorable)
<b>Revenues</b>			
Contributions	\$ 1,102,442	\$ 1,052,436	\$ (50,006)
Management fees	52,243	52,243	-
Investment income - interest and dividends	-	42,165	42,165
Investment income - change in fair value	-	73,966	73,966
Total revenues	<u>1,154,685</u>	<u>1,220,810</u>	<u>66,125</u>
<b>Administrative Expenses</b>			
Claims benefit payments	961,688	442,123	519,565
VLCT services	88,200	78,196	10,004
Claims services	35,000	34,261	739
Legal services	5,000	3,572	1,428
Audit and accounting services	8,500	7,501	999
Actuarial services	5,500	4,523	977
Bank costs	1,900	1,210	690
Investment consulting fees	1,400	1,103	297
Investment management fees	2,100	2,282	(182)
Insurance	3,300	1,453	1,847
Board of Directors	7,000	6,236	764
Board travel and training	3,000	1,557	1,443
Staff travel and training	1,700	3,227	(1,527)
Vehicle expenses	500	264	236
Printing	500	-	500
Member training	-	100	(100)
Dues and subscriptions	1,250	1,223	27
Town Fair	750	-	750
Miscellaneous	100	-	100
Total administrative expenses	<u>1,127,388</u>	<u>588,831</u>	<u>538,557</u>
<b>Member Relations</b>			
VLCT services	9,500	8,429	1,071
Staff travel and training	100	288	(188)
Vehicle expense	500	70	430
Program supplies	100	-	100
Printing	100	-	100
Promotionals	500	-	500
Communications	1,000	-	1,000
Total member relations expenses	<u>11,800</u>	<u>8,787</u>	<u>3,013</u>
Total expenses	<u>1,139,188</u>	<u>597,618</u>	<u>541,570</u>
Excess of Revenues over Expenses	<u>\$ 15,497</u>	<u>\$ 623,192</u>	<u>\$ 607,695</u>