

VLCT Unemployment Insurance Trust, Inc.

Audited Financial Statements
with Supplementary Information

*Years ended December 31, 2013 and 2012
with Report of Independent Auditors*

VLCT Unemployment Insurance Trust, Inc.

Audited Financial Statements
with Supplementary Information

Years ended December 31, 2013 and 2012

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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., which comprise the statements of net position as of December 31, 2013 and 2012, 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, 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.

Other Matters

Required Supplementary Information

The accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis on pages 3 - 13 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 VLCT Unemployment Insurance Trust, Inc.'s basic audited financial statements. The other information on page 25 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.

A handwritten signature in cursive script that reads "Johnson Lambert LLP". The signature is written in black ink and is positioned to the right of the date and location information.

Burlington, Vermont
April 28, 2014

Vermont firm registration: 092-0000267

VLCT Unemployment Insurance Trust, Inc.

Management's Discussion and Analysis

Years ended December 31, 2013 and 2012

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, 2013, 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 2013 by \$2,246,124, with an increase in total assets of \$294,554 (13.2%) and a decrease in liabilities of \$8,371 (2.9%). Assets exceeded liabilities in 2012 by \$1,943,199, with total assets increasing by \$579,148 (35.0%) and liabilities decreasing by \$44,044 (13.1%). Both increases were the result of operating surpluses with strong investment earnings strengthening total assets in 2012.
- Net position in 2013 increased by \$302,925 or 15.6% from 2012. This compares to an increase of \$623,192 or 47.2% experienced last year. The increase in 2013 was primarily the result of an operating surplus that reflected lower than budgeted claim payments. Member contribution rates are set based on the worst case scenario to ensure that there will be enough to cover claim payments or leave a surplus that will serve as a reserve during economic downturns or will be returned in the form of member contribution credits. The increase in 2012 was due to a decrease in claim payments of \$227,892 or 34.0% combined with an increase in contributions of \$39,307 or 3.9%.
- The ratio of net position to total assets increased from 87.0% in 2012 to 88.8% in 2013. This ratio measures the ability of the Trust to withstand both unanticipated increases in claims that are not offset by contributions and negative market performance during the year. The increase from 2012 to 2013 is from a planned underwriting surplus to ensure contributions will cover future benefit payments resulting from economic downturns. The increase from 2011 to 2012 was due to a combination of conservative underwriting, an improved economy resulting in fewer claims, and strong investment earnings.
- The Trust returned \$287,250 in the form of rate credits to the members during the 2013 renewal. Rate credits of \$50,000 were returned to members in 2012. In 2013, the Board of Directors (the Board) approved rate credits of \$400,000 to be applied against 2014 contributions. This amount has been restricted in the statement of net position as of December 31, 2013.

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 an enterprise fund. The Trust's operations primarily include determination and collection of appropriate member contributions, issuance of claim benefit payments and payment of 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 Equifax 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, 2013 and 2012 and financial developments during 2013 and 2012 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, 2013 and 2012, 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, 2013 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, 2013</u>	<u>December 31, 2012</u>	<u>Percentage Change</u>	<u>December 31, 2011</u>	<u>Percentage Change</u>
Assets					
Cash and Investments	\$ 2,448,942	\$ 2,212,566	10.7 %	\$ 1,634,821	35.3 %
Other assets	<u>80,096</u>	<u>21,918</u>	265.4 %	<u>20,515</u>	6.8 %
Total assets	\$ 2,529,038	\$ 2,234,484	13.2 %	\$ 1,655,336	35.0 %
Liabilities					
	<u>\$ 282,914</u>	<u>\$ 291,285</u>	(2.9)%	<u>\$ 335,329</u>	(13.1)%
Net Position					
Restricted	400,000	287,250	39.3 %	50,000	474.5 %
Unrestricted	<u>1,846,124</u>	<u>1,655,949</u>	11.5 %	<u>1,270,007</u>	30.4 %
Total net position	<u>\$ 2,246,124</u>	<u>\$ 1,943,199</u>	15.6 %	<u>\$ 1,320,007</u>	47.2 %

VLCT Unemployment Insurance Trust, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis - Continued

As of December 31, 2013, total assets increased by 13.2% from \$2,234,484 to \$2,529,038, compared to an increase of 35.0% from 2011 to 2012. Operating surplus contributed to an increase in cash and investments of \$236,376 or 10.7% in 2013, while operating surplus combined with investment earnings contributed to an increase in cash and investments of \$577,745 or 35.3% in 2012. The investment portfolio grew by about 6.9% and 10.7% in 2013 and 2012, respectively (\$88,324 and \$123,302 respectively) with little change in earnings from interest, dividends and realized gains.

As of December 31, 2013, total current liabilities decreased by 2.9% from \$291,285 to \$282,914 compared with a decrease of 13.1% from 2011 to 2012. A decrease in unearned income accounted for the drop in liabilities for 2013 while a decrease in claim liabilities was the driver of the decrease in 2012. A higher surplus amount was approved to be returned to members in the form of contribution credits for the 2014 renewal year, resulting in lower unearned income at the end of 2013. The receipts for contributions paid in advance will not be recognized as revenue until 2014 and are therefore classified as a liability (unearned income) as of December 31, 2013. The 2012 claim liabilities decrease was from a reduction in fourth quarter claims, recorded as a payable to the Vermont Department of Labor.

Net position increased in 2013 by 15.6% or \$302,925 from 2012. This compares to an increase of \$623,192 or 47.2% in 2012 from 2011. The increase in 2013 was primarily the result of an underwriting surplus. Claim benefit payments were conservatively projected during the rate-setting process and actual claim payments were almost \$500,000 lower than the projection. The member contribution credits of \$287,250 reduced this savings, the net result accounting for most of the operating surplus of \$228,873. Actual claim benefit payments in 2012 were less than the amount estimated for rate-setting by \$519,565, which was offset by a \$50,000 rate credit, and accounted for most of that year's operating surplus.

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 five 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 amounts or benefit duration changes that occur as a result of legislative actions could significantly impact this ratio.

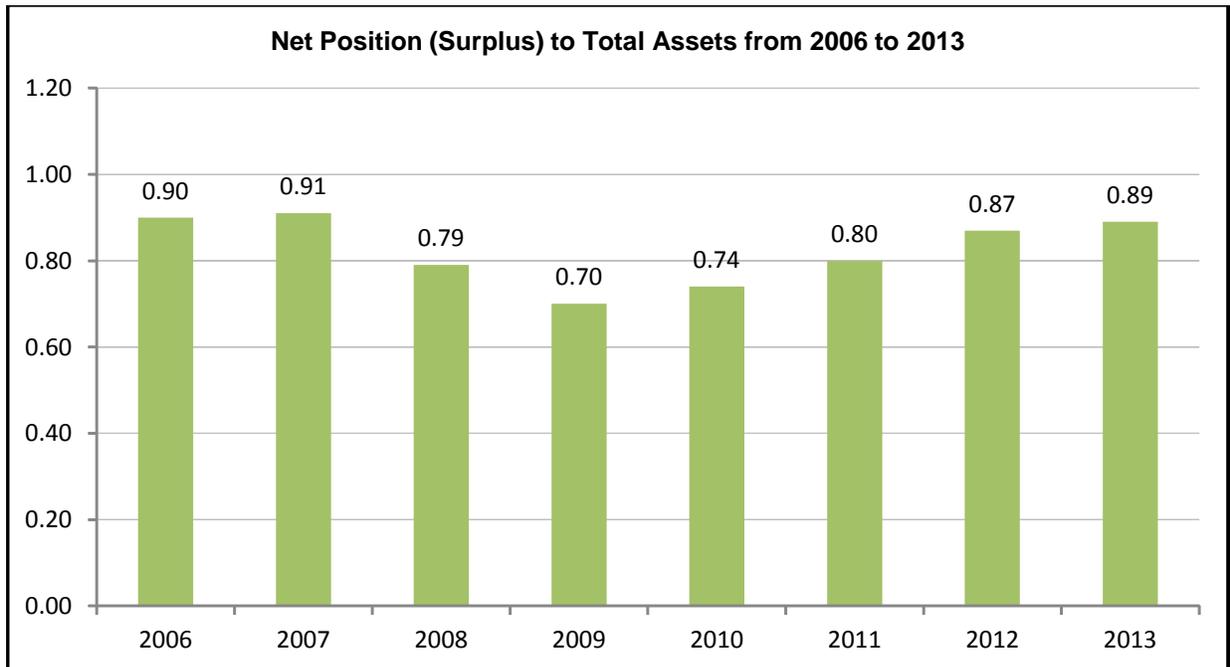
Because the Trust is fully self-insured and has no reinsurance to fall back on, a positive net position amount is particularly important for financial stability as shown by the trend leading up to the 2008 recession in the chart below. Though the Trust's ratio was over 90% in 2007, the large increase 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

VLCT Unemployment Insurance Trust, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis - Continued

some very significant rate increases to recoup the losses. With strong operating and investment performance between 2011 and 2013, 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

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

	December 31, 2013	December 31, 2012	Percentage Change	December 31, 2011	Percentage Change
Operating Revenues					
Fund contributions	\$ 841,344	\$ 1,052,436	(20.1)%	\$ 1,013,129	3.9 %
Management fees	<u>52,000</u>	<u>52,243</u>	(0.5)%	<u>52,000</u>	0.5 %
Total operating revenues	893,344	1,104,679	(19.1)%	1,065,129	3.7 %
Operating Expenses					
Claims benefit payments	486,298	442,123	10.0 %	670,015	(34.0)%
Operating expenses	<u>178,173</u>	<u>152,110</u>	17.1 %	<u>164,719</u>	(7.7)%
Total operating expenses	<u>664,471</u>	<u>594,233</u>	11.8 %	<u>834,734</u>	(28.8)%
Operating income	<u>228,873</u>	<u>510,446</u>	(55.2)%	<u>230,395</u>	121.6 %
Non-Operating Revenues					
Investment income, net of fees	<u>74,052</u>	<u>112,746</u>	(34.3)%	<u>56,855</u>	98.3 %
Change in net position	302,925	623,192	(51.4)%	287,250	117.0 %
Net Position, Beginning of Year	<u>1,943,199</u>	<u>1,320,007</u>	47.2 %	<u>1,032,757</u>	27.8 %
Net Position, End of Year	<u>\$ 2,246,124</u>	<u>\$ 1,943,199</u>	15.6 %	<u>\$ 1,320,007</u>	47.2 %

The Trust had an operating income of \$228,873 in 2013 compared with an operating income of \$510,446 for 2012 and \$230,395 in 2011. As indicated above, a conservative rate-setting methodology in 2013 resulted in almost \$500,000 in underwriting surplus reduced by the member contribution credits of \$287,250. In 2011 and 2012, 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. Post-recession rate-setting with the current methodology allows for a gradual replenishment of surplus to build sufficient reserves to withstand the next economic downturn.

The increase in contributions (before contributions credits) for 2013 reflected a rate of 1.9% that was intended to cover 2013 projected claims based on 2012 benefits. The average rate in 2012 was 1.9% as well. The taxable wage base was \$16,000 in both 2012 and 2013.

Claim benefit payments increased by 10.0% from 2012 to 2013 compared to a 34.0% decrease from 2011 to 2012. The increase appears to be in lack of work claims, with seasonal and temporary assignments accounting for most of it. However when the data is analyzed for year over year changes in individual member payments, the largest increases were from a small

VLCT Unemployment Insurance Trust, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis - Continued

number of claims for involuntary separation due to unsatisfactory performance or failure to comply with company policy. Because the contribution estimates reflected rates that anticipated worst case benefit disbursements, these payments were under budget by approximately \$497,002 or 50.5%.

Operating expenses for the year increased from 2012 by \$26,063 or 17.1%, primarily due to the change in the allocation method for the VLCT administrative agreement costs which reduced the amount returned to the Trust from the year-end true-up. Beginning in 2013, only the direct costs are reconciled at year-end with the difference between budgeted and actual returned to the Trust. Indirect costs are charged as budgeted in order to reduce the volatility in allocated costs across all programs. The most significant variance from the amount budgeted was the depreciation savings for a software implementation that was not completed until later in the year than originally anticipated.

Net investment earnings for 2013 were \$74,052 compared with net investment earnings of \$112,746 in 2012. Out of this total, there was a net increase in the fair value of investments (net realized and net unrealized) of \$35,206 in 2013 compared with an increase of \$73,966 in 2012. The balance of the year to year change in net investment earnings for both years is in interest and dividends earned. Losses in the fixed income portfolio contributed to this decrease in earnings from 2012 to 2013.

The asset allocation at the end of 2013 is comprised of 33.4% equities, 65.4% fixed income, and 1.2% cash equivalents. This compares with 28.6% equities, 69.2% fixed income, and 2.2% cash equivalents at the end of 2012, and with 27.0% equities, 70.0% fixed income, and 3.0% cash equivalents at the end of 2011. Weighted returns at year end 2013 were -1.93% for the fixed income portfolio (compared with the Barclays Capital Aggregate market index of -2.35%), while the equity portfolio showed weighted returns of 25.05% (compared with the blended benchmark of 26.61%). Although equities did not perform well against the benchmark as measured over the year, since inception they have outperformed the benchmark by 1.13%.

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, 2013:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Operating Revenues			
Fund contributions	\$ 1,139,050	\$ 841,344	\$ (297,706)
Management fees	<u>52,500</u>	<u>52,000</u>	<u>(500)</u>
Total operating revenues	1,191,550	893,344	(298,206)
Operating Expenses			
Claims benefit payments	983,300	486,298	497,002
Operating expenses - all cost centers	<u>199,873</u>	<u>178,173</u>	<u>21,700</u>
Total operating expenses	<u>1,183,173</u>	<u>664,471</u>	<u>518,702</u>
Operating excess of revenues over expenditures	8,377	228,873	220,496
Non-operating - investment income (loss)	<u>(3,600)</u>	<u>74,052</u>	<u>77,652</u>
Excess of Revenues Over Expenditures	<u>\$ 4,777</u>	<u>\$ 302,925</u>	<u>\$ 298,148</u>

As shown in this budget analysis, the operating surplus of \$228,873 significantly exceeded the budgeted operating income of \$8,377. The variance in actual operating surplus to budget is attributable to the conservative rate-setting process, with estimated claim benefit payments based on worst case scenario as previously discussed.

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. Distributions of \$287,250 in the form of renewal rate credits were returned to members in 2013. A \$50,000 distribution was returned to members in 2012.

On the revenue side, contributions were under budget by \$297,706, a combination of the rate credit that was approved for 2013 and the loss of one member. 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 \$77,652 in excess of budget, increasing the overall variance over budget to \$298,148.

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 2000 to 2012 (with 2012 projected), and applied to the 2013 projected taxable wage base of \$59.95 million. 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). The payout for 2012 dropped to 0.76%. 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 10.0% lower. In 2013, all quarters were higher than in 2012, with the exception of the first quarter, with claim payments ending the year 10.0% higher than the prior year.

Operating expenses were lower than budgeted in 2013 primarily due to a decrease in data service costs which ended the year below budget by \$12,324. The purchase of a software program for underwriting and billing was completed later in the year than anticipated, reducing the depreciation amount well below was originally anticipated.

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

- Actuarial costs were below budget by \$1,220 or 16.3%, primarily due to conservative budgeting that includes sufficient funding for developing alternative funding scenarios as necessary.
- Legal services were lower than anticipated by \$3,960 or 79.2% due to a combination of diligent followups after the initial claim filings and improved economic conditions.
- Bank costs were over budget by \$907 or 60.5% due primarily to charges for services that were not assessed fees previously.
- Board travel costs were lower than budget by \$1,952 or 65.1% with fewer Board members attending conferences than expected.
- Administration staff travel costs were higher than budget by \$948 or 36.5%. The budget reflected a breakout of travel into training/conference and member outreach for the first time and the amount of travel anticipated for each was not estimated as high as it should have been.

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 saw a slight uptick in its claims over the past year. This followed a trend of stable or dropping claims which began in the second quarter of 2010.

As a result of continuing positive results, the Trust's rates for 2014 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:

Year	Average Rate	Trust Taxable Wages*	Taxable Wage Base
2014	1.90%	\$60.0 million	\$16,000
2013	1.90%	\$60.0 million	\$16,000
2012	1.90%	\$57.7 million	\$16,000
2011	2.18%	\$46.6 million	\$13,000

The taxable wage base is the maximum amount used per employee, or their actual wages if below the maximum. The wage base is set by the State and had historically been \$8,000 for many years. Due to the impact of the 2009 recession on the State's unemployment insurance trust, the amount was increased to \$10,000 in 2010 and then increased two more times to \$13,000 in 2011 and to the current \$16,000 in 2012. The State may change the wage base annually but has chosen not to do so since 2012.

The 2014 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 \$400,000, which is a substantial increase over the 2013 contribution rate credit of \$287,250. The Board also decided to set aside some funds for developmental startup costs for potential new business opportunities such as a human resources assistance program.

Claims have remained relatively stable and are below their 2009-2010 highs. This should allow the Trust to continue to maintain a strong net position to meet its obligations going forward.

The Trust implemented a new underwriting management software system for the 2014 renewal. The implementation process went smoothly. The new system (NavRisk), purchased from the same company (David Corp.) that provides underwriting and claims administration software to VLCT PACIF, will lead to more accurate and efficient renewal underwriting and program administration.

VLCT Unemployment Insurance Trust, Inc.

Management's Discussion and Analysis (Continued)

Outlook and Economic Factors - Continued

VLCT Health Trust, Inc. and VLCT Unemployment Insurance Trust, Inc. Boards of Directors met in March 2014 to discuss the possibility of merging the two trusts, as well as new business opportunities. Based on these discussions, each Board voted unanimously to move forward with a merger. The merger would need final approval of the Board and membership of each trust before it could be completed. The target date for a merger is January 1, 2015.

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>2013</u>	<u>2012</u>
Assets		
Cash and cash equivalents	\$ 1,088,843	\$ 940,791
Debt Securities, at fair value	900,083	899,914
Mutual funds, at fair value	460,016	371,861
Accrued investment income	7,477	8,211
Prepaid expenses	72,619	2,835
Net due from VLCT	<u>-</u>	<u>10,872</u>
 Total Assets	 <u>\$ 2,529,038</u>	 <u>\$ 2,234,484</u>
 Liabilities and Net Position		
Liabilities		
Due to Vermont Department of Labor	\$ 130,117	\$ 113,158
Unearned income	139,000	166,792
Net due to VLCT	3,996	-
Accounts payable	<u>9,801</u>	<u>11,335</u>
Total liabilities	282,914	291,285
 Net Position		
Restricted	400,000	287,250
Unrestricted	<u>1,846,124</u>	<u>1,655,949</u>
Total net position	<u>2,246,124</u>	<u>1,943,199</u>
 Total Liabilities and Net Position	 <u>\$ 2,529,038</u>	 <u>\$ 2,234,484</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,	
	2013	2012
Operating Revenues		
Member contributions	\$ 841,344	\$ 1,052,436
Management fees	52,000	52,243
Total operating revenues	893,344	1,104,679
 Operating Expenses		
Claims benefit payments	486,298	442,123
General and administrative expenses	178,173	152,110
Total operating expenses	664,471	594,233
 Net operating income	228,873	510,446
 Non-Operating Revenues (Expenses)		
Investment income	42,315	42,165
Investment income - net realized gains and change in fair value	35,206	73,966
Investment management fees	(2,320)	(2,282)
Investment consulting fees	(1,149)	(1,103)
 Net non-operating revenues	74,052	112,746
 Change in Net Position	302,925	623,192
 Net Position, Beginning of Year	1,943,199	1,320,007
 Net Position, End of Year	\$ 2,246,124	\$ 1,943,199

See accompanying notes to the financial statements.

VLCT Unemployment Insurance Trust, Inc.

Statements of Cash Flows

	Years ended December 31,	
	2013	2012
Cash Flows from Operating Activities		
Receipts for member contributions	\$ 813,552	\$ 1,046,857
Receipts for management fees	52,000	52,243
Payments for claims	(469,339)	(482,373)
Payments for general and administrative expenses	(234,623)	(153,174)
Net cash provided by operating activities	161,590	463,553
 Cash Flows from Investing Activities		
Receipts of interest income	43,049	43,611
Investment management fees	(2,320)	(2,282)
Investment consulting fees	(1,149)	(1,103)
Purchases of investments	(1,135,187)	(778,294)
Proceeds of investments	1,082,069	728,958
Net cash used in investing activities	(13,538)	(9,110)
 Net Change in Cash and Cash Equivalents	148,052	454,443
 Cash and Cash Equivalents, Beginning of Year	940,791	486,348
 Cash and Cash Equivalents, End of Year	\$ 1,088,843	\$ 940,791
 Reconciliation of Operating Income to Net Cash Provided By Operating Activities		
Net operating income	\$ 228,873	\$ 510,446
Changes in assets and liabilities:		
Prepaid expenses	(69,784)	(1,518)
Due from VLCT	14,868	(1,331)
Due to Vermont Department of Labor	16,959	(40,250)
Unearned income	(27,792)	(5,579)
Accounts payable	(1,534)	1,785
 Net cash provided by operating activities	\$ 161,590	\$ 463,553

See accompanying notes to the financial statements.

VLCT Unemployment Insurance Trust, Inc.

Notes to the Financial Statements

Years ended December 31, 2013 and 2012

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) payment of 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 210 and 211 members as of December 31, 2013 and 2012, respectively.

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 of America ("U.S. 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 28, 2014, the date on which these financial statements were available to be issued.

Use of Estimates

The preparation of financial statements in conformity with U.S. 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, 2013 and 2012 are classified as Due to Vermont Department of Labor on the statements of net position.

Debt Securities/Mutual Funds

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 are determined using the specific identification method for debt securities and the average cost method for mutual funds. 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, 2013 and 2012 were as follows:

	December 31, 2013		December 31, 2012	
	Book Balance	Bank Balance	Book Balance	Bank Balance
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	838,843	838,837	690,791	696,085
Total	\$ 1,088,843	\$ 1,088,837	\$ 940,791	\$ 946,085

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, as well as payments for the unexpired portion of software and software-related service agreements, 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 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, 2013 and 2012 for member contributions with coverage effective dates of January 1, 2014 and January 1, 2013, 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.

Reclassifications

Certain reclassifications have been made in the 2012 audited financial statements to conform to the 2013 presentation, which had no effect on net position or change in net position.

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, 2013 and 2012.
- *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, 2013				
	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	Total
U.S. Treasuries	\$ 11,036	\$ 150,855	\$ 6,474	\$ 51,075	\$ 219,440
U.S. Agencies	-	-	-	121,982	121,982
U.S. Agency MBS	11,019	29,485	41,190	22	81,716
Corporate Bonds	21,293	71,901	134,625	213,351	441,170
Municipal Bonds	-	4,638	5,471	19,638	29,747
Foreign Bonds	-	-	-	6,028	6,028
Total	\$ 43,348	\$ 256,879	\$ 187,760	\$ 412,096	\$ 900,083

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, 2013:

	U.S. <u>Treasuries</u>	U.S. <u>Agencies</u>	U.S.Agency <u>MBS</u>	Corporate <u>Bonds</u>	Municipal <u>Bonds</u>	Foreign <u>Bonds</u>	<u>Total</u>
AAA	\$ -	\$ 42,513	\$ -	\$ 94,308	\$ -	\$ -	\$ 136,821
AA+	219,440	79,469	81,716	8,641	-	-	389,266
AA	-	-	-	13,328	14,309	-	27,637
AA-	-	-	-	-	5,471	-	5,471
A+	-	-	-	16,381	4,637	6,028	27,046
A	-	-	-	48,813	5,330	-	54,143
A-	-	-	-	79,738	-	-	79,738
BBB+	-	-	-	109,659	-	-	109,659
BBB	-	-	-	41,688	-	-	41,688
Not Rated	-	-	-	28,614	-	-	28,614
Total	<u>\$ 219,440</u>	<u>\$ 121,982</u>	<u>\$ 81,716</u>	<u>\$ 441,170</u>	<u>\$ 29,747</u>	<u>\$ 6,028</u>	<u>\$ 900,083</u>

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, 2013:

	<u>Fair Value</u>	<u>Effective Duration</u>
U.S. Treasuries	\$ 219,440	6.77
U.S. Agencies	121,982	3.98
U.S. Agency MBS	81,716	2.29
Corporate Bonds	441,170	6.79
Municipal Bonds	29,747	10.62
Foreign Bonds	<u>6,028</u>	6.95
Total	<u>\$ 900,083</u>	5.49

The average effective duration of the investment portfolio as of December 31, 2013 and 2012, was 5.49 and 5.87 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, 2013 and 2012:

<u>Classification</u>	<u>2013 Fair Value</u>	<u>2012 Fair Value</u>
Large Cap Blend	\$ 139,401	\$ 62,211
Large Cap Growth	-	57,797
Large Cap Value	137,428	62,625
Mid Cap Blend	48,206	-
Mid Cap Growth	-	58,971
Mid Cap Value	-	64,581
Small Cap Blend	49,054	65,676
High Yield	43,582	-
World Bond	42,345	-
Total	<u>\$ 460,016</u>	<u>\$ 371,861</u>

Net realized gains on the sale of investments were \$50,829 and net unrealized losses attributable to the change in fair value of investments were \$15,623 for the year ended December 31, 2013. 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.

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, 2013 and 2012, expenses allocated to the Trust were \$108,644 and \$86,625, respectively. These costs are included as a component of general and administrative expenses on the statements of revenues, expenses and changes in net position. As of December 31, 2013, the Trust owed VLCT \$3,996. As of December 31, 2012, VLCT owed the Trust \$10,872.

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, 2013, the Trust has established a target net position of \$1,493,951 based on an actuarial assessment of variability of net income. The target net position represents a 99.9% confidence level as of December 31, 2013. 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, 2012, the Trust established a target net position of \$1,315,260.

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 \$287,250 and 50,000 of contribution credits to the members during the years ended December 31, 2013 and 2012, respectively. During 2013, the Board also approved \$400,000 of contribution credits to be allocated to individual members upon renewal in 2014. Contribution credits approved by the Board for distribution during the following renewal year are recorded as restricted on the statements of net position.

Note F - Subsequent Event

VLCT Health Trust, Inc. and VLCT Unemployment Insurance Trust, Inc. Boards of Directors met in March 2014 to discuss the possibility of merging the two trusts, as well as new business opportunities. Based on these discussions, each Board voted unanimously to move forward with a merger. The merger would need final approval of the Board and membership of each trust before it could be completed. The target date for a merger is January 1, 2015.

VLCT Unemployment Insurance Trust, Inc.

Schedule of Revenues and Expenses - Budgetary Basis

December 31, 2013

(Unaudited)

	Budget	Actual	Variance Favorable / (Unfavorable)
Revenues			
Contributions	\$ 1,139,050	\$ 841,344	\$ (297,706)
Management fees	52,500	52,000	(500)
Investment income - interest and dividends	-	42,315	42,315
Investment income - change in fair value	-	35,206	35,206
Total revenues	1,191,550	970,865	(220,685)
Administrative Expenses			
VLCT services	94,228	93,749	479
Claims services	36,000	35,395	605
Data services	14,000	1,676	12,324
Legal services	5,000	1,040	3,960
Audit and accounting services	8,500	8,560	(60)
Actuarial services	7,500	6,280	1,220
Bank costs	1,500	2,408	(908)
Investment consulting fees	1,200	1,149	51
Investment management fees	2,400	2,320	80
Insurance	1,500	1,320	180
Board of Directors	7,000	6,559	441
Board travel and training	3,000	1,048	1,952
Staff travel and training	2,600	3,548	(948)
Vehicle expenses	100	117	(17)
Printing	500	-	500
Dues and subscriptions	1,250	1,476	(226)
Town Fair	1,000	-	1,000
Total administrative expenses	187,278	166,645	20,633
Member Relations			
VLCT services	15,395	14,895	500
Staff travel and training	100	-	100
Vehicle expense	100	57	43
Promotionals	500	45	455
Communications	100	-	100
Total member relations expenses	16,195	14,997	1,198
Claims benefits payments	983,300	486,298	497,002
Total expenses	1,186,773	667,940	518,833
Excess of Revenues over Expenses	\$ 4,777	\$ 302,925	\$ 298,148