

MERCANTILE SELF INSURANCE TRUST

FINANCIAL STATEMENTS

DECEMBER 31, 2011



INDEPENDENT AUDITORS' REPORT

Board of Directors
Mercantile Self Insurance Trust
Buffalo, New York

We have audited the accompanying balance sheet of Mercantile Self Insurance Trust as of December 31, 2011, and the related statements of operations, changes in members' deficit and cash flows for the year then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

We were unable to obtain oral or written representations from 2011's management, inquire of them and others about fraud risks, or observe certain internal control procedures of the Mercantile Self Insurance Trust. As disclosed in Note 1, the State of New York Workers' Compensation Board (WCB) assumed management of the Trust in 2012.

In our opinion, except for the effects of such adjustments that may have been determined to be necessary had we been able to perform the procedures referred to in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Mercantile Self Insurance Trust as of December 31, 2011, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 8, the Trust eliminated the application of a discount rate to its reserve for losses and loss adjustment expenses. In addition, in 2011 the Trust recorded restricted cash of \$115,697 which was received by the WCB in 2009. Beginning members' deficit has been restated for the change in accounting principle and correction of an error.

EFP Rotenberg, LLP

EFP Rotenberg, LLP
Rochester, New York
July 31, 2013

MERCANTILE SELF INSURANCE TRUST
Balance Sheet
December 31, 2011

ASSETS

Assets

Cash and cash equivalents	\$ 331,796
Investments	808,794
Accrued interest receivable	9,007
Restricted cash	920,056
Second injury fund receivable	1,170,503
Contributions receivable, net of allowance for doubtful accounts of \$4,400,029	445,122
Prepaid income taxes	13,610
Prepaid expenses	7,190
Reinsurance recoverable	<u>3,612,000</u>
Total Assets	<u>\$ 7,318,078</u>

LIABILITIES AND MEMBERS' DEFICIT

Liabilities

Reserve for losses and loss adjustment expenses	
Case reserves	\$ 8,245,000
Incurred but not reported	7,297,000
Unallocated loss adjustment expenses	<u>395,000</u>
	15,937,000
Accounts payable and accrued expenses	104,497
Workers Compensation Board assessments payable - current	297,014
Workers Compensation Board assessments payable - prior incurred	1,895,722
Accrued Workers' Compensation Board assessments	<u>1,569,742</u>
Total Liabilities	19,803,975
Members' Deficit	<u>(12,485,897)</u>
Total Liabilities and Members' Deficit	<u>\$ 7,318,078</u>

The accompanying notes are an integral part of these financial statements.

MERCANTILE SELF INSURANCE TRUST
Statement of Operations
For the Year Ended December 31, 2011

Revenue

Interest income	\$ 58,356
Realized gain on investments	55,623
Total revenue	<u>113,979</u>

Expenses

Loss and loss adjustment expenses	5,417,532
NYS Workers' Compensation Board assessments	2,021,456
Management, general and administrative expenses	382,031
Income taxes	4,300
Total expenses	<u>7,825,319</u>

Net Loss

(7,711,340)

The accompanying notes are an integral part of these financial statements.

MERCANTILE SELF INSURANCE TRUST
Statement of Changes in Members' Deficit
For the Year Ended December 31, 2011

	<u>Accumulated Other Comprehensive Income</u>	<u>Accumulated Deficit</u>	<u>Total Members' Deficit</u>
Balance - January 1, 2011	\$ 100,628	\$ (3,296,301)	\$ (3,195,673)
Restatement (Note 8)		115,697	115,697
Change in Accounting Principle (Note 8)		(1,666,000)	(1,666,000)
Net loss	-	(7,711,340)	(7,711,340)
Reclassification adjustment	(28,581)	-	(28,581)
Balance - December 31, 2011	<u>\$ 72,047</u>	<u>\$ (12,557,944)</u>	<u>\$ (12,485,897)</u>

The accompanying notes are an integral part of these financial statements.

MERCANTILE SELF INSURANCE TRUST
Statement of Cash Flows
For the Year Ended December 31, 2011

Cash Flows from Operating Activities

Net loss	\$ (7,711,340)
Adjustments	
Bad debt expense	(83,188)
Gain on sale investments, net	(55,623)
Changes in assets and liabilities	
Accrued interest receivable	4,287
Second injury fund receivable	(1,170,503)
Contributions receivable	1,288,947
Prepaid expenses	(7,190)
Reinsurance recoverable	(3,612,000)
Reserve for losses and loss adjustment expenses	8,103,000
Accounts payable and accrued expenses	2,037,483
Net cash flows from operating activities	<u>(1,206,127)</u>

Cash Flows from Investing Activities

Transfers to restricted cash	3,255
Proceeds from investments sold or matured	821,631
Net cash provided by investing activities	<u>824,886</u>

Net Change in Cash and Cash Equivalents (381,241)

Cash and Cash Equivalents - Beginning 713,037

Cash and Cash Equivalents - Ending \$ 331,796

The accompanying notes are an integral part of these financial statements.

MERCANTILE SELF INSURANCE TRUST
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies and Scope of Business

Scope of Business - The Mercantile Self Insurance Trust (the Trust) is a workers' compensation self-insurance Trust (Trust) under New York State Workers' Compensation Law Section 50. The Trust is comprised of employers in the retail distribution and sale of food products industries in New York State who entered into an agreement to pool the costs related to workers' compensation benefits. The Trust ceased writing business on February 29, 2008.

Effective June 1, 2012, the State of New York Workers' Compensation Board (WCB) assumed the administration and final distribution of the Trust's assets and liabilities pursuant to the provisions of Workers' Compensation Law. Future assessments to members are expected to satisfy estimated liabilities in full.

Method of Accounting and Estimates - The Trust maintains its books and prepares its financial statements on the accrual basis of accounting. The Trust changed its basis of accounting from the liquidation basis to the accrual basis in 2011 because the Trust expects to continue as a going concern for several years and to settle its outstanding claims in the normal course of business. The change in basis did not materially affect the Trust's net deficit position.

Cash and Cash Equivalents - Cash and cash equivalents include time deposits, certificates of deposit, and all highly liquid debt instruments with original maturities of three months or less. The Trust maintains cash and cash equivalents at financial institutions which periodically may exceed federally insured amounts.

Investment Valuation and Income Recognition - Investments are stated at fair market value based on quoted prices in an active market. Purchases and sales of securities are recorded on a trade date basis. Interest income is recorded on the accrual basis.

ASC 820-10 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Contributions Receivable and Allowance for Doubtful Accounts - Contributions receivable are stated net of an allowance for doubtful accounts. The Trust estimates the allowance based on its analysis of specific balances, taking into consideration the age of past due accounts, and anticipated collections resulting from legal action. Receivables are considered impaired if payment is not received in accordance with terms. It is the Trust's policy to charge off uncollectible receivables when management determines the receivable will not be collected. One member comprised approximately 15% of net contributions receivable as of December 31, 2011.

Restricted Cash - Restricted cash is comprised of amounts held by the WCB to satisfy any claims, liabilities, obligations, expenses or assessments of the Trust.

MERCANTILE SELF INSURANCE TRUST
Notes to Financial Statements

Reserve for Losses and Loss Adjustment Expenses - The liability for losses and loss adjustment expenses includes amounts determined from loss reports and individual cases and includes an estimate of losses incurred but not reported. Reserves for losses and loss adjustment expenses are based on Trust and industry experience. Trends have been determined in consultation with independent counseling actuaries.

Reserve for losses and loss adjustment expenses include estimates of future trends in loss severity and frequency and other factors which could vary as the losses are ultimately settled. Accordingly, it is at least reasonably possible that actual incurred losses and loss adjustment expenses will vary significantly from the estimated amounts included in these financial statements.

Accrued Workers' Compensation Board Assessment - The Trust has an accrued assessment liability which reflects an estimate of the ultimate cost expected to be paid by the Trust for all of the NYS Workers' Compensation Board's legally mandated assessments. In April 2011, the New York State Governor enacted legislation that will significantly reduce future WCB assessments due from insolvent and inactive trusts. Specifically, the new legislation eliminates future assessments pursuant to sections 151, 15-8, and 25-A of the Worker's Compensation Law and various interdepartmental charges. The change is effective as of January 1, 2011.

However the amendments to the law did not eliminate the self insurance assessment pursuant to section 50-5 of the Workers Compensation Law. Therefore, the Trust has calculated this accrued assessment on a basis of 10.1% of the estimated loss and allocated loss adjustment expense (ALAE) as of December 31, 2011.

The liability is comprised of three components in the accompanying balance sheet: Workers' Compensation Board assessments payable - current (liability related to the activity subsequent to 2010 assessment cycle), Workers' Compensation Board assessments payable - prior incurred (liability related to activity through 2010 assessment cycle), and accrued Workers' Compensation Board assessments.

Contributions - Through February 29, 2008, contributions were based upon actual payroll of each Trust member and adjusted for loss experience. In the event that Trust funds including reinsurance are not sufficient to cover operating costs, the Trust members are assessed additional contributions to meet the Trust's obligations. Also, in the event a Trust member is unable to pay its respective obligations, the Trust is responsible to satisfy all obligations of that member.

Income Taxes - Federal income taxes are provided for in the accompanying financial statements based upon taxable income as computed under Federal income tax regulations. New York State taxes are calculated based on normal corporate income tax rates.

In accordance with ASC 740-10-50, the Trust recognizes the tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Interest and/or penalties related to income tax matters, if incurred, are recognized as a component of income tax expense. The Trust's income tax filings are subject to audit by various tax authorities. The Trust's open audit periods are 2009 through 2011.

Subsequent Events - In accordance with ASC 855-10, the Trust evaluated subsequent events through July 31, 2013, the date these financial statements were available to be issued.

MERCANTILE SELF INSURANCE TRUST
Notes to Financial Statements

Note 2. Reserve for Losses and Loss Adjustment Expenses

The components of the reserve for losses and loss adjustment expenses as of December 31, 2011, are as follows:

Balance - beginning (restated)	\$ 7,834,000
Incurred relating to prior years	10,202,608
Paid claims relating to prior years	<u>(2,099,608)</u>
Balance - ending	<u>\$ 15,937,000</u>

Note 3. Reinsurance

The Trust has specific excess insurance for each policy year of the Trust. The insurance coverage is for excess of the retention as follows:

	<u>Amount</u>	<u>Period</u>
Specific retention:	\$ 300,000	October 1, 1994 - September 30, 1999
	\$ 350,000	October 1, 1999 - September 30, 2001
	\$ 400,000	October 1, 2002 - December 31, 2003
	\$ 500,000	January 1, 2004 - February 28, 2006
	\$ 400,000	March 1, 2006 - December 31, 2006 (Layer 1)
	\$ 1,000,000	March 1, 2006 - December 31, 2006 (Layer 2)
	\$ 5,000,000	March 1, 2006 - December 31, 2006 (Layer 3)
	\$ 10,000,000	March 1, 2006 - December 31, 2006 (Layer 4)
	\$ 400,000	January 1, 2007 - February 29, 2008

Reinsurance receivables and income are recorded when claims losses exceed reinsurance limits. In the event the reinsurers are unable to satisfy their obligations under the reinsurance policies, the Trust would have primary liability for losses incurred.

Note 4. Income Taxes

As of December 31, 2011, the Trust had approximately \$12 million of federal and state net operating loss carryforwards for income tax reporting purposes. These carryforwards may be used to offset future taxable income and begin to expire in 2028. A valuation allowance has been recorded in full against assets associated with these operating loss carryforwards since management recognizes future tax benefits of net operating loss carryforwards only to the extent that realization of such benefits is more likely than not.

MERCANTILE SELF INSURANCE TRUST
Notes to Financial Statements

Note 5. Investments

Investments consisted of the following as of December 31:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
U.S. Treasury Obligations	\$ 178,488	\$ -	\$ -	\$ 178,488
U.S. Government Obligations	-	332,680	-	332,680
Corporate Bonds:				
Baa2	21,511	-	-	21,511
Common Stocks:				
Basic materials	78,311	-	-	78,311
Conglomerates	16,708	-	-	16,708
Consumer goods	49,165	-	-	49,165
Financial	20,959	-	-	20,959
Healthcare	25,280	-	-	25,280
Industrial Goods	14,513	-	-	14,513
Services	21,069	-	-	21,069
Technology	35,684	-	-	35,684
Total common stocks	<u>261,689</u>	<u>-</u>	<u>-</u>	<u>261,689</u>
Mutual Funds:				
Value funds	14,426	-	-	14,426
Total investment at fair value	<u>\$ 476,114</u>	<u>\$ 332,680</u>	<u>\$ -</u>	<u>\$ 808,794</u>

Note 6. Related Party

The Trust has entered into an agreement with an affiliated management administrator for management of the Trust and administration of claims during its run off. Management fees paid to this entity are included in professional and administrative fees and were \$179,217 during 2011. Amounts due to this entity, included in accounts payable and accrued expenses were \$14,721 at December 31, 2011.

Note 7. Commitments, Contingencies, and Uncertainties

The Trust has a participation agreement with each member to provide risk management services and workers' compensation coverage through February 29, 2008. The agreement stipulates, among other things, that each member is jointly and severally liable for the workers' compensation obligations of the Trust, irrespective of the subsequent termination of the membership in the Trust, the insolvency or bankruptcy of another member of the Trust, or other facts or circumstances. Accordingly, the financial viability of the Trust is contingent upon the financial viability of the individual members.

Note 8. Change in Accounting Principle and Correction of an Error

During 2011, the Trust changed its accounting for reserve for losses and loss adjustment expenses by eliminating the discount to estimated present value. Presentation of undiscounted liabilities is preferred by the WCB. Consequently, beginning members' deficit has been increased by \$1,666,000. Net loss for 2011 and reserve for losses and loss adjustment expenses as of December 31, 2011 are approximately \$1,000,000 higher than they would have been without this change in accounting principle.

During 2011, the Trust recorded \$115,697 of cash held by the WCB since 2009. Consequently, beginning members' deficit as of January 1, 2011 was increased by this amount.