MERCANTILE SELF-INSURANCE TRUST

FINANCIAL STATEMENTS

December 31, 2014

Lumsden McCormick LLP
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

New York State Workers' Compensation Board
Mercantile Self-Insurance Trust

We have audited the accompanying balance sheet of Mercantile Self-Insurance Trust (the Trust) as of December 31, 2014, and the related statements of income and changes in accumulated deficit, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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 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 auditors' 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 Trust'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 Trust'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 the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for Qualified Opinion

As more fully described in Note 1 to the financial statements, the New York State Workers' Compensation Board determined the financial stability of the Trust could not be restored in a timely and appropriate manner, and initiated steps for the future dissolution of the Trust. The accompanying financial statements have been prepared in accordance with accounting principles applicable to a going concern, and thus include the amounts applicable to a trust able to continue operations indefinitely into the future. Accounting principles generally accepted in the United States of America require that assets and liabilities be carried on a liquidation basis, and that future revenues and expenses expected to be realized be accrued when a trust is in the process of liquidation or liquidation is imminent. The principal effects of that departure from U.S. generally accepted accounting principles on the financial statements are not reasonably determinable.

Qualified Opinion

In our opinion, except for the effects of the matter discussed in the Basis for Qualified Opinion paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Trust as of December 31, 2014, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Lumsden & McCormick, LLP

May 13, 2015

Balance Sheet

December 31, 2014

Assets:		
Cash	$	1,001,669
Contributions receivable, net (Note 2)		212,202
Special assessments receivable, net (Note 3)		65,463
Second injury fund receivable (Note 4)		36,911
Prepaid expenses		425,258
Deferred income taxes		6,386,600
	$	8,128,103
Liabilities and Members' Equity		
Liabilities:		
Accounts payable and accrued expenses	$	74,318
Workers' Compensation Board assessments payable - current		224,949
Workers' Compensation Board assessments payable - prior incurred		2,185,327
Accrued Workers' Compensation Board assessments - ALP exit fee		339,380
Due to NYS Workers' Compensation Board assessment account funds (Note 6)		15,426,351
		18,250,325
Members' equity:		
Accumulated deficit		(10,122,222)
	$	8,128,103

See accompanying notes.

Statement of Income and Changes in Accumulated Deficit

For the year ended December 31, 2014

Revenues:	
Interest and other income	$ 1,626
Expenses:	
Incurred losses and loss adjustment (Note 5)	1,262,998
Workers' Compensation Board assessments	(364,822)
Workers' Compensation Board assessments - ALP exit and guarantee fee	647,907
Legal, management, and other professional fees	178,697
Bad debts	(71,520)
Miscellaneous	4,431
	1,657,691
Loss before income taxes	(1,656,065)
Provision for income taxes (benefit) (Note 7)	(640,675)
Net loss	(1,015,390)
Accumulated deficit - beginning	(9,106,832)
Accumulated deficit - ending	$ (10,122,222)

See accompanying notes.

Statement of Cash Flows

For the year ended December 31, 2014

Operating activities:		
Net loss	$	(1,015,390)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Deferred income taxes		(640,700)
Bad debts expense (recovery)		(71,520)
Changes in other operating assets and liabilities:		
Contributions and special assessments receivable		75,724
Second injury fund receivable		214,984
Reinsurance recoverable		3,561,119
Prepaid expenses		(406,533)
Unpaid losses and loss adjustment expenses		(17,781,928)
Workers' Compensation Board assessments		(25,442)
Due to NYS Workers' Compensation Board assessment account funds		15,426,351
Net operating activities		(663,335)
Net change in cash		(663,335)
Cash - beginning		1,665,004
Cash - ending	$	1,001,669

Supplemental cash flows information:		
Income taxes paid	$	25

See accompanying notes.

Notes to Financial Statements

1. Summary of Significant Accounting Policies:

Organization:

Mercantile Self-Insurance Trust (the Trust) is a self-insurance trust established in 1994. Its member employers were primarily engaged in the retail distribution and/or sale of food products in the State of New York. The Trust provided workers' compensation insurance for employees of its members through February 29, 2008. The Trust is not responsible for any claim obligations incurred by its members prior to entering the Trust.

The Trust is currently in run-off status. When certain forensic accounting procedures are completed, a deficit assessment will be issued by the New York State Workers' Compensation Board (the WCB) to all members. Payments for future claims and administrative expenses will be made from Trust funds held by the WCB, advances from WCB assessment account funds, and from member payments on the future WCB issued deficit assessment billing.

The Trust is currently administered by NCAComp, Inc., an unrelated organization hired by the WCB to provide third party administrative services. In accordance with the Trust agreement, participants are responsible for deficits.

Pursuant to title 12 of New York State Codes, Rules and Regulations Section 317.20, the WCB determined the financial stability of the Trust could not be restored in a timely and appropriate manner, and accordingly, on June 1, 2012, initiated steps for the future dissolution of the Trust. The WCB has effectively assumed the responsibility for all administrative duties of the Trust, including the payment of claims for accidents incurred through February 29, 2008. In the event the Trust's assets are inadequate to fund future operations, the WCB is required to fund future remaining claims and related obligations of the Trust.

Sale of Claims Liabilities:

Part R of Chapter 56 of the Laws of 2010 allows self insurers to execute an assumption of workers' compensation liability policy (ALP), which transfers the tail of claims incurred while self insured to an assuming carrier. Part R also states that the premium paid for such a policy must include a surcharge (exit fee) in an amount determined by the Chair of the WCB to address the assessments that would have been paid by the self insurer if these claims were not transferred to the carrier through an ALP. An ALP transaction effective February 1, 2014 was executed with a commercial insurance carrier. Accordingly, effective February 1, 2014, the Trust is no longer responsible to pay any claims expenses, and a liability to the NYS Workers' Compensation Board assessment account funds was established on the accompanying balance sheet for the payment of the transaction. An exit fee relating to this transaction has been accrued on the accompanying balance sheet.

Subsequent Events:

The Trust has evaluated events and transactions for potential recognition or disclosure in the financial statements through May 13, 2015 (the date the financial statements were available to be issued).

Cash:

Cash in financial institutions may exceed insured limits at various times during the year and subject the Trust to concentrations of credit risk.

Contributions Receivable:

Contributions receivable represent amounts applicable to periods through February 29, 2008. The WCB provides for probable uncollectible amounts through a charge to earnings and a credit to allowance for doubtful accounts based on its assessment of the current status of individual accounts. Balances still outstanding after the WCB has used reasonable collection efforts are removed through a charge to allowance for doubtful accounts and a credit to contributions receivable.

Special Assessments Receivable:

Special assessments receivable represent remaining balances on amounts assessed to members prior to June 1, 2012. The WCB provides for probable uncollectible amounts through a charge to earnings and a credit to allowance for doubtful accounts based on its assessment of the current status of individual accounts. Balances still outstanding after the WCB has used reasonable collection efforts are removed through a charge to allowance for doubtful accounts and a credit to special assessments receivable.

Workers' Compensation Board Assessments:

In April 2011, the New York State Governor enacted legislation that reduced WCB assessments due from insolvent and inactive trusts. Specifically, the new legislation eliminated assessments for 151, 15-8, 25-A and IDP for periods subsequent to December 31, 2010.

As a result of this legislative change and the ALP transaction, the Trust has calculated the WCB assessment liability at 2.2% of the ALP price (exit fee) in addition to unbilled amounts the Trust owes through December 31, 2014.

This liability is comprised of three components on the accompanying balance sheet: Workers' Compensation Board assessments payable – current (liability related to activity subsequent to the 2010 assessment cycle), Workers' Compensation Board assessments payable – prior incurred (liability related to activity through the 2010 assessment cycle), and accrued Workers' Compensation Board assessments – ALP exit fee.

Income Taxes:

The Trust provides currently for income taxes applicable to all items included in the financial statements, regardless of when such taxes are payable. Deferred assets and liabilities are recognized for the expected future tax consequences of temporary differences between the tax and financial statement bases of assets and liabilities. Temporary differences arise from using different methods of accounting for bad debts, and New York State Workers' Compensation Board assessments. Additionally, the Trust recognizes future tax benefits of net operating loss carryforwards to the extent that realization of such benefits is more likely than not. The Trust believes it is no longer subject to examination by Federal and State taxing authorities for years prior to fiscal year ended December 31, 2011.

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

2. Contributions Receivable:

Contributions receivable	$ 346,202
Less allowance for doubtful accounts	134,000
	$ 212,202

3. Special Assessments Receivable:

Special assessments receivable	$ 5,540,463
Less allowance for doubtful accounts	5,475,000
	$ 65,463

4. Second Injury Fund Receivable:

When an eligible claim is approved under New York State's second injury fund (Section 15-8), the Trust is reimbursed for additional losses for previously injured employees. At December 31, 2014, amounts submitted for reimbursement and yet to be repaid by New York State to the Trust on paid losses eligible for reimbursement under the second injury fund totaled $36,911.

5. Unpaid Losses and Loss Adjustment Expenses:

Balance - beginning of year	$ 17,781,928
Less reinsurance recoverables	3,561,119
Net balance - beginning of year	14,220,809
Incurred related to:	
Current year	-
Prior years	1,262,998
	1,262,998
Net paid or settled related to:	
Current year	-
Prior years	(15,483,807)
	(15,483,807)
Net balance - end of year	-
Add reinsurance recoverables	-
Balance - end of year	$ -
Net paid or settled consists of:	
Total paid or settled during the year	$ 15,483,807
Less proceeds received on reinsurance claims	-
	$ 15,483,807

6. Due to NYS Workers' Compensation Board Assessment Account Funds:

Group and individual self-insurers pay assessments into WCB assessment account funds. Through December 31, 2014, the Trust received advances from WCB assessment accounts funds. These amounts will be paid back from future revenue received from the WCB.

7. Income Taxes:

Current provision:	
Federal	$ -
State	25
	25
Deferred provision (benefit):	
Federal	(523,100)
State	(117,600)
	(640,700)
	$ (640,675)

The Trust's effective tax rate varies from the statutory federal tax rate primarily as a result of graduated tax rates and state taxes net of federal benefits.

Deferred income taxes on the balance sheet at December 31, 2014 consist entirely of assets, net of a valuation allowance of $116,600.

At December 31, 2014, the Trust has approximately $15,404,000 of federal and state net operating loss carryforwards for income tax reporting purposes. These carryforwards may be used to offset future taxable income, and expire in varying amounts through 2034.

Realization of a deferred tax asset is dependent on generating sufficient taxable income at the time temporary differences become deductible. The Trust provides a valuation allowance to the extent that deferred tax assets may not be realized. The amount of the deferred tax asset considered to be realizable could be reduced in the near term if estimates of future taxable income during the carryforward period were reduced.