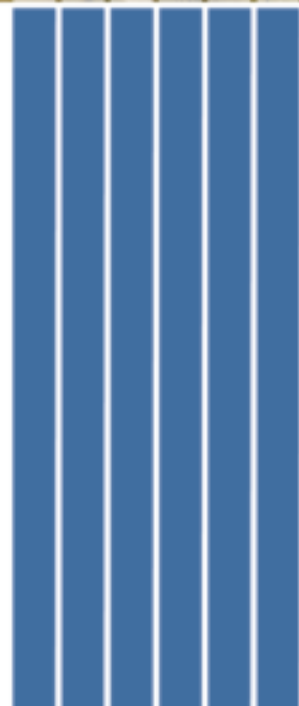




2007

**UK**  
UNIVERSITY  
OF KENTUCKY

*University of Kentucky*  
**Consolidated  
Financial  
Statements**



# University of Kentucky Consolidated Financial Statements Year Ended June 30, 2007

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## MESSAGE FROM THE PRESIDENT

I think 2006-07 at the University of Kentucky can best be summed up in one word: Momentum.

Excitement and support for the university's Top 20 Business Plan was evident throughout campus, the community and the Commonwealth. From our Board of Trustees members to our students, faculty, staff, alumni and friends, our Top 20 quest was at the center of many conversations.

You could feel the momentum in the classroom, as we admitted the largest and most diverse freshman class in UK history in fall 2006. Nearly 4,200 first-year students called UK home. This year's class included 294 African-American students, a 96 percent increase from last year, and 57 Hispanic students, representing a 54 percent increase over last year.

We did not simply concentrate on bringing in more students; our Admissions Office focused on attracting brighter, more academically-prepared students who can lead us in our Top 20 mission. Last year's incoming class included 354 Governor's Scholars and Governor's School for the Arts students, shattering our previous record of 318.

Our students continued to show something we have known around this campus for a long time: They are some of the best and the brightest in the world.

- Five UK students will receive government-funded Fulbright Scholarships for graduate study and research abroad for the 2007-2008 academic year, making it UK's largest class of Fulbright scholars for an academic year.
- Several undergraduates competed in the National Conference on Undergraduate Research in April. UK had 16 research papers accepted at the conference. The University of Michigan, a national leader in undergraduate research, had 20. Two other leading research universities, the University of California-Berkley and the University of Texas at Austin, had 13 and 12 papers accepted, respectively.
- Andrew Lynch, a junior from Corbin, Kentucky, majoring in chemical engineering, was awarded three of this nation's most prestigious scholarships this spring. He was named a Udall,

Goldwater, and Beckman Scholar. Only 80 sophomores and juniors nationwide receive the Udall Scholarship each year and only 317 students were named Goldwater Scholars.

It was also a monumental year for our student-athletes. Several of our teams excelled in competition throughout the year. UK football topped off one of its finest seasons in history by capturing the Music City Bowl championship in December. The Kentucky women's soccer team capped its magical run through the Southeastern Conference by winning the SEC title. Harry Mullins led the UK Rifle team to another terrific season and was named conference Coach of the Year for his efforts.

UK Diver Taryn Ignacio and Coach Mike Lyden set the gold standard of diving excellence in the Southeastern Conference. In 2007, Taryn was named SEC Diver of the Year and Mike was tabbed Coach of the Year for the third consecutive season. In the past three seasons, Taryn, a native of Richmond, Kentucky, has captured five SEC titles, three on the platform and two on the one-meter board. She also won the national title in platform last year. Her five SEC titles are the most of any Kentucky swimmer or diver in history – male or female.

The Top 20 momentum could be felt in our capital campaign. UK achieved its billion dollar capital campaign this spring, becoming one of only 31 American universities that have successfully completed campaigns of that size. The campaign, which was completed nine months ahead of schedule, brought in 640,000 gifts from 122,000 donors.

It was a year in which our research enterprise soared to new heights, as the university's total research expenditures for fiscal year 2006, as reported to the National Science Foundation, increased to a record-high \$324 million. The university's continuing upward trend in research expenditures helped propel UK from 26th to 24th in ranking for the research domain as being tracked in our Top 20 Business Plan.

It was also a time for growth, expansion, and improved quality within UK HealthCare. We broke ground on three major construction projects on the southern end of campus this year. The new \$24 million University Health Service building, the \$120 million College of Pharmacy, and the \$450 million UK Chandler Hospital are



*President Lee T. Todd Jr.*

currently under construction. The three projects are major components of UK's quest to build the Commonwealth's Medical Campus of the Future.

UK HealthCare added to its regional network in June by receiving approval to acquire one of Lexington's most storied medical facilities, Good Samaritan Hospital. Not only will the move bolster our medical enterprise, it saved more than 500 central Kentucky jobs and preserved a vital community hospital.

UK Chandler Hospital was named one of the nation's 100 Top Performance Improvement Leaders by Thomson Healthcare (formerly Solucient), an organization that has been identifying America's top performing hospitals since 1993 and is well-known among the health care industry. UK is the only academic medical center in Kentucky to receive the ranking, which is based on UK Chandler Hospital's continued strong growth in financial performance, operational efficiency, and quality care for patients. For the second time in two years, UK is ranked by Thomson Healthcare among the top 15 academic medical centers in the nation for having faster and more consistent organization-wide improvement than most other teaching hospitals. Rankings released in July by U.S. News & World Report place UK Chandler Hospital among the nation's top hospitals. Of 5,462 U.S. hospitals evaluated, only 173 made the list. UK

Chandler Hospital is the only Lexington hospital included and one of only three in the state. Three of UK's programs – gynecology; ear, nose and throat; and cancer – were recognized by the magazine for their excellence.

Momentum could be felt in the areas of commercialization and economic development. Five new companies were created as a result of university intellectual property. It was also a banner period for Coldstream Research Campus, as 16 new companies and 181 employees were added to that campus.

Our drive to become a Top 20 public research university has captured the attention of higher education leaders across the country. We hosted several prominent visitors this year, each of whom was seeking to learn more about our Business Plan. Officials from West Virginia, a legislator from Georgia, and a delegation from the University of Illinois all spent time on campus discussing our planning process.

The most significant change since we unveiled our Top 20 Business Plan is not something that can be calculated in a statistical analysis or benchmarked against other institutions. But it is just as important as any scientific measure. There has been a seismic cultural shift on this campus. The change in attitude can be felt across campus – in conversations with students, faculty, and staff.

There is a newfound belief that the University of Kentucky is uniquely positioned to change the Commonwealth of Kentucky.

There is a belief that the decisions and sacrifices made on campus today will positively impact lives for years to come.

Most importantly, there is a belief that our Top 20 dream truly is possible.

A handwritten signature in cursive script, reading "Lee T. Todd Jr." The signature is written in dark ink on a light background.

Lee T. Todd Jr.  
President

## INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of the University of Kentucky

and

the Secretary of Finance and Administration Cabinet of the  
Commonwealth of Kentucky

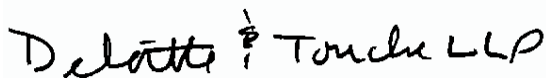
We have audited the accompanying consolidated statements of net assets of the University of Kentucky (the "University") (an agency of the Commonwealth of Kentucky) and affiliated corporations as of June 30, 2007 and 2006, and the related consolidated statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. The financial statements of Kentucky Medical Services Foundation, Inc., Kentucky Technology, Inc. and Subsidiaries, and Kentucky Healthcare Enterprises, Inc. were audited in accordance with generally accepted auditing standards, but were not audited in accordance with *Government Auditing Standards*. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the University of Kentucky and affiliated corporations as of June 30, 2007 and 2006, and their changes in net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 2 through 12 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the University's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 5, 2007, on our consideration of internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



October 5, 2007

# Management's Discussion and Analysis

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of the University of Kentucky (the University) and its affiliated corporations for the years ended June 30, 2007 and 2006. Management has prepared this discussion, and we encourage you to read it in conjunction with the consolidated financial statements and the notes appearing in this report.

## **About the University of Kentucky**

From Paducah to Pikeville, Covington to Cumberland, the University of Kentucky touches lives across the Bluegrass State, providing education, cultural stimulation and economic development in all 120 counties. Considering that residents of all Kentucky counties benefit from the University's medical care, community service, innovative research, and creative teaching and instruction, there's no question UK is *The* University of Kentucky.

**History.** Nestled in the heart of Kentucky's scenic Bluegrass region, UK was founded in 1865 as a land-grant university. From its beginnings with only 190 students and 10 professors, UK's campus now covers more than 716 acres in Lexington and is home to more than 27,000 students and more than 13,500 employees.

**Mission.** The University of Kentucky has long embraced its mission to provide excellent education to outstanding resident and non-resident students, recognizing that a knowledgeable populace is the best foundation for a prosperous Commonwealth. This mission has been further enhanced since 1997 when the Kentucky General Assembly mandated that UK become a Top 20 public research university by 2020. President Lee T. Todd Jr. focused the University on achieving this goal through the development of a Top 20 Business Plan in 2005 that gained national prominence for its vision and detail.

**Students.** Students from 117 countries, every state in the nation and every Kentucky county provide a diverse learning and cultural environment that enriches the educational experience at UK. While the student population has enjoyed steady growth in the past several years, the average ACT score of entering freshmen has continually exceeded the national average and is competitive with UK's benchmark institutions – the top public universities in America. The high quality of UK's students is confirmed by their successful competition for the most prestigious awards, including the Fulbright, Truman, Goldwater and Marshall scholarships. UK has twice been selected as one of only 13 universities nationwide to participate in the Beckman Foundation Scholarship Program, allowing the University to award grants to students to support their own research projects. Boasting 12 Truman Scholars, UK has won recognition from the Harry S. Truman Foundation as an honor institution for exemplary participation in the program.

**Outreach.** Thousands of Kentuckians from across the state feel the impact of UK's research and public service annually, through programs aimed at improving industrial productivity, agricultural profitability and home life. Programs like the Health Education through Extension Leadership bring the results of health research to local communities, helping boost the quality of life across the state.

Meanwhile, Kentuckians have responded to the University's commitment to the Commonwealth through their remarkable support of The Campaign for the University of Kentucky. The fundraising effort – the largest in state history – to enhance facilities, academic programs, public service and scholarships recently surpassed its \$1 billion goal. The generosity of UK's alumni and friends allowed it to fully utilize its allocation of state support available through Kentucky's Research Challenge Trust Fund program.

**Programs.** UK students enjoy an enormous array of choices, with some 200 majors and degree programs in 17 academic and professional colleges available. UK is one of only a few public universities

nationally to house colleges of Agriculture, Arts and Sciences, Business and Economics, Communications and Information Studies, Dentistry, Design, Education, Engineering, Fine Arts, Health Sciences, Law, Libraries, Medicine, Nursing, Pharmacy, Public Health and Social Work on a single campus.

**Research.** "Determination" is truly the word describing UK's focus on achieving its Top 20 research goal. For the last five years, the University has consistently exceeded \$200 million in sponsored projects awards. UK faculty recently attracted a record-breaking total of \$290 million in extramural funding for grants and contracts. A recent ranking placed UK at 26th among all public universities for federal expenditures. Meanwhile, the inventiveness of UK faculty continues to earn the University its standing as 17th among land-grant universities, 34th among public universities, and 57th overall in licensing income and patents. Another national ranking recently put UK 19th among public institutions for the scholarly productivity of its faculty.

**Medical Center.** The UK Chandler Medical Center, opened in 1960, stands among the nation's finest academic medical centers. Its faculty, students and staff take pride in achieving excellence in education, patient care, research and community service. One of two Level 1 Trauma Centers in Kentucky, UK cares for the most critically injured and ill patients in the region. More than 500 faculty physicians and dentists, 400 resident physicians and a staff of 3,200 health professionals provide care in the 473-bed UK Chandler Hospital and Kentucky Children's Hospital.

In spring 2007, ground was broken for a new \$450 million UK Chandler Hospital. This more than 1-million square foot facility, to be completed in 2011, is the cornerstone of a 20-year, \$2.5 billion plan to construct the Commonwealth Medical Campus of the Future. Among the campus' components are a now-under-construction \$120 million pharmacy building, additional research buildings, a new shared Health Sciences Learning Center, and additional buildings to house programs for the colleges of Medicine, Nursing, Health Sciences, Dentistry and Public Health.

**Libraries.** No university can provide adequate opportunities to its students – or to the residents of the state it serves – without outstanding library facilities. The University of Kentucky exceeds expectations because it operates a nationally recognized research library system, with the capstone being the world-class William T. Young Library. UK's book endowment is the largest among public universities. Its library network and technology provide extraordinary service to students in the colleges of Medicine, Law, Engineering, Fine Arts and other programs. Meanwhile, students, faculty and Kentucky residents can use UK Libraries' advanced technology to access the most up-to-date information from online journals, government publications and private studies.

**Agenda.** UK's agenda aims to accelerate the University's movement toward academic excellence in all areas and gaining worldwide recognition for its outstanding academic programs, its commitment to undergraduates, its success in building a diverse community, and its engagement with the larger society. It's all part of the University's strategy to help position Kentucky as a leader in American prosperity.

### **Financial Highlights**

The University's overall financial position remains strong with assets of \$3.14 billion and liabilities of \$859.9 million. Net assets, which represent the University's residual interest in assets after liabilities are deducted, were \$2.28 billion or 73 percent of total assets.

- Total assets increased \$325.5 million, or 12 percent, primarily due to increases in endowment investments and capital assets, net.
- Total liabilities increased \$150.0 million, or 21 percent, primarily due to the issuance of additional bonds, notes, capital leases and other long-term obligations for the purchase and/or construction of land, buildings, equipment and computer software.

- Total net assets increased \$175.5 million, or 8 percent, due to an increase in net capital assets of \$10.5 million; an increase in restricted net assets of \$107.2 million, primarily due to investment income on endowments, net of spending distributions, of \$69.1 million and gifts and other additions to endowments of \$29.9 million; and an increase of \$57.9 million in unrestricted net assets, primarily due to excess revenues over expenses in the hospital of \$47.8 million.
- Operating revenues were \$1.44 billion and operating expenses were \$1.81 billion, resulting in a loss from operations of \$373.3 million. Nonoperating and other revenues, including \$319.9 million in state appropriations, net of nonoperating expenses, were \$548.8 million, which, when combined with the loss from operations, resulted in an overall increase in net assets of \$175.5 million.

### **Using the Consolidated Financial Statements**

The University presents its financial reports in a “business type activity” format, in accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* and GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. In addition to this MD&A section, the financial report includes a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, a Statement of Cash Flows and Notes to the Financial Statements. GASB requires that statements be presented on a consolidated basis to focus on the University as a whole.

### **Reporting Entity**

The University of Kentucky is a component unit of the Commonwealth of Kentucky. The consolidated financial statements of the University include the operations of the University and the following entities:

- University of Kentucky Research Foundation, and its for-profit subsidiaries, Kentucky Technology, Inc. and Coldstream Laboratories, Inc.
- University of Kentucky Athletic Association
- The Fund for Advancement of Education and Research in the University of Kentucky Medical Center
- University of Kentucky Business Partnership Foundation, Inc.
- University of Kentucky Center on Aging Foundation, Inc.
- University of Kentucky Gluck Equine Research Foundation, Inc.
- University of Kentucky Humanities Foundation, Inc.
- University of Kentucky Mining Engineering Foundation, Inc.
- Central Kentucky Management Services, Inc.
- Kentucky Medical Services Foundation, Inc.
- Kentucky Healthcare Enterprises, Inc., a for-profit subsidiary.

### **Consolidated Statement of Net Assets**

The Consolidated Statement of Net Assets is the University’s balance sheet. It reflects the total assets, liabilities and net assets (equity) of the University as of June 30, 2007, with comparative information as of June 30, 2006. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Net assets, the difference between total assets and total liabilities, are an important indicator of the University’s current financial condition, while the change in net assets is an indicator of whether the overall financial position has improved or worsened during the year. Generally, assets and liabilities are reported using current values. A major exception is capital assets, which are stated at historical cost, less accumulated depreciation. A summarized comparison of the University’s assets, liabilities and net assets at June 30, 2007, 2006 and 2005 is as follows:



**Condensed Consolidated Statements of Net Assets (in thousands)**

|  | <u>2007</u>         | <u>2006</u>         | <u>2005</u>         |
|--|---------------------|---------------------|---------------------|
| <b>ASSETS</b>                                      |                     |                     |                     |
| Current assets                                     | \$ 608,720          | \$ 551,899          | \$ 512,426          |
| Capital assets, net of depreciation                | 1,208,670           | 1,081,156           | 1,028,064           |
| Other noncurrent assets                            | 1,320,191           | 1,178,993           | 904,618             |
| Total Assets                                       | <u>3,137,581</u>    | <u>2,812,048</u>    | <u>2,445,108</u>    |
| <b>LIABILITIES</b>                                 |                     |                     |                     |
| Current liabilities                                | 299,995             | 229,343             | 213,913             |
| Noncurrent liabilities                             | 559,935             | 480,603             | 368,039             |
| Total Liabilities                                  | <u>859,930</u>      | <u>709,946</u>      | <u>581,952</u>      |
| <b>NET ASSETS</b>                                  |                     |                     |                     |
| Invested in capital assets,<br>net of related debt | 773,962             | 763,476             | 750,485             |
| Restricted   |                     |                     |                     |
| Nonexpendable                                      | 454,316             | 423,755             | 393,224             |
| Expendable   | 383,817             | 307,195             | 217,643             |
| Unrestricted                                       | 665,556             | 607,676             | 501,804             |
| Total Net Assets                                   | <u>\$ 2,277,651</u> | <u>\$ 2,102,102</u> | <u>\$ 1,863,156</u> |

**Assets.** As of June 30, 2007, total assets amounted to \$3.14 billion. Of this amount, investment in capital assets (net of depreciation) of \$1.21 billion, or 39 percent of total assets, represented the largest asset class. Endowment investments amounted to \$945.3 million, or 30 percent of total assets, and cash and cash equivalents amounted to \$515.4 million, or 16 percent of total assets. During the year, total assets increased by \$325.5 million primarily due to increases in endowment investments resulting from market value appreciation and gifts, and capital assets due to new additions of land, buildings, equipment and computer software.

**Liabilities.** As of June 30, 2007, total liabilities amounted to \$859.9 million. Bonds and notes payable, capital leases and other long-term obligations issued for educational buildings, the housing and dining system, the University hospital, the William T. Young library, equipment and computer software amounted to \$537.5 million, or 63 percent of total liabilities. During the year, total liabilities increased by \$150.0 million primarily due to the issuance of additional debt, principally for the construction of a new student health facility, for computer software, and to lease land, buildings and equipment.

**Net Assets.** The equity of the University of \$2.28 billion as of June 30, 2007 is reported on the statement of Net Assets in four net asset categories: invested in capital assets, net of related debt, \$774.0 million (34 percent); restricted-nonexpendable, \$454.3 million (20 percent); restricted-expendable, \$383.8 million (17 percent); and unrestricted, \$665.6 million (29 percent).

Restricted net assets are subject to externally imposed restrictions governing their use. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the unrestricted net assets have been internally designated for support of academic and research programs and initiatives, capital projects, and working capital requirements.

Total net assets increased \$175.5 million during the year ended June 30, 2007. Invested in capital assets, net of related debt, increased \$10.5 million primarily due to payment of current year maturities of principal on bonds and capital leases. Restricted net assets increased \$107.2 million, primarily due to endowment investment returns which increased from 10.0% to 16.8% compared to the prior year, resulting in an increase in investment income on endowments, net of spending distributions, of \$69.1 million. Unrestricted net assets increased \$57.9 million, primarily due to excess revenues over expenses in the hospital of \$47.8 million and general funds revenues in excess of expenses of \$6.9 million.

**2006 Versus 2005.** During the year ended June 30, 2006:

- Total assets increased by \$366.9 million, primarily due to increases in cash and cash equivalents and capital assets, net, from the proceeds of debt issued during the year, as well as increases in endowment investments and other increases in capital assets.
- Liabilities increased by \$128.0 million, primarily due to the issuance of additional debt, principally for the hospital patient care facility project.
- Total net assets increased by \$238.9 million during the year ended June 30, 2006. Invested in capital assets, net of related debt, increased by \$13.0 million, primarily due to payment of current year maturities of principal on bonds and capital leases. Restricted net assets increased by \$120.1 million, primarily due to gifts and other additions to endowments of \$36.4 million, investment income on endowments, net of spending distributions, of \$25.2 million, and capital grants from the Commonwealth of Kentucky restricted for building projects of \$48.5 million. Unrestricted net assets increased \$105.9 million, primarily due to excess revenues over expenses in the hospital of \$68.9 million and general funds revenues in excess of expenses.

#### **Consolidated Statement of Revenues, Expenses and Changes in Net Assets**

The Consolidated Statement of Revenues, Expenses and Changes in Net Assets is the University's income statement. It details how net assets have increased during the year ended June 30, 2007, with comparative information for the year ended June 30, 2006. This statement is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. All items that increase or decrease net assets must appear on the Consolidated Statement of Revenues, Expenses and Changes in Net Assets as revenues, expenses, gains or losses.

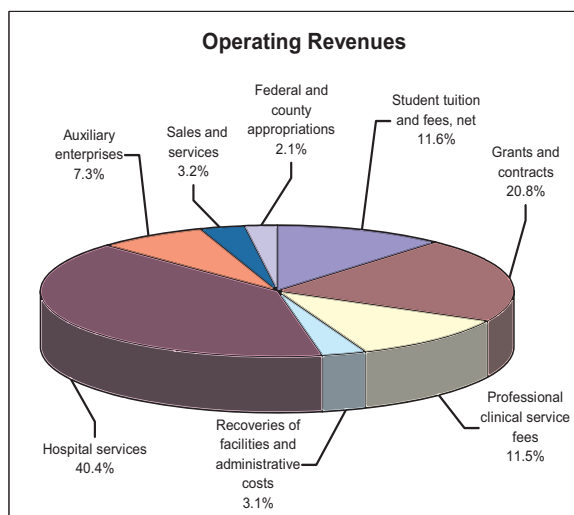
Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts, and investment and endowment income to be classified as nonoperating revenues. Accordingly, the University reports a net operating loss for the year prior to the addition of nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. Tuition revenue is reduced by gift scholarships and institutional aid, and is reported net of scholarship allowances in the financial statements. A summarized comparison of the University's revenues, expenses and changes in net assets for the years ended June 30, 2007, 2006 and 2005 is as follows:

**Condensed Consolidated Statements of Revenues, Expenses and Changes in Net Assets**  
**(in thousands)**

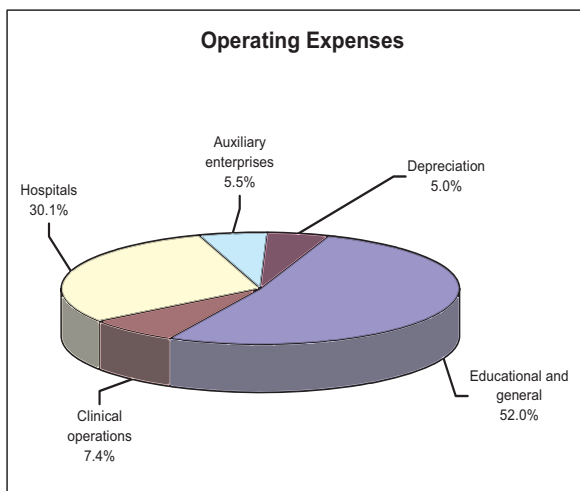
|   | <u>2007</u>                | <u>2006</u>                | <u>2005</u>                |
|---|----------------------------|----------------------------|----------------------------|
| <b>OPERATING REVENUES</b>                               |                            |                            |                            |
| Student tuition and fees, net of scholarship allowances | \$ 166,742                 | \$ 147,267                 | \$ 133,389                 |
| Grants and contracts                                    | 298,237                    | 297,361                    | 268,219                    |
| Hospital services                                       | 579,222                    | 520,310                    | 440,609                    |
| Professional clinical service fees                      | 164,432                    | 150,241                    | 142,154                    |
| Auxiliary enterprises, net of scholarship allowances    | 105,005                    | 102,080                    | 95,249                     |
| Sales and services                                      | 45,717                     | 42,024                     | 38,857                     |
| Recoveries of facilities and administrative costs       | 43,792                     | 43,303                     | 40,332                     |
| Federal and county appropriations                       | 30,675                     | 27,682                     | 27,703                     |
| Other operating revenues                                | 1,507                      | 2,222                      | 466                        |
| Total operating revenues                                | <u>1,435,329</u>           | <u>1,332,490</u>           | <u>1,186,978</u>           |
| <b>OPERATING EXPENSES</b>                               |                            |                            |                            |
| Educational and general, excluding depreciation         | 940,314                    | 864,844                    | 797,183                    |
| Clinical operations, excluding depreciation             | 133,271                    | 119,910                    | 116,852                    |
| Hospital, excluding depreciation                        | 544,914                    | 475,767                    | 387,685                    |
| Auxiliary enterprises, excluding depreciation           | 99,630                     | 94,825                     | 87,884                     |
| Depreciation  | 90,270                     | 83,761                     | 78,219                     |
| Other operating expenses                                | 229                        | 460                        | 382                        |
| Total operating expenses                                | <u>1,808,628</u>           | <u>1,639,567</u>           | <u>1,468,205</u>           |
| <b>OPERATING LOSS</b>                                   | <u>(373,299)</u>           | <u>(307,077)</u>           | <u>(281,227)</u>           |
| <b>NONOPERATING REVENUES (EXPENSES)</b>                 |                            |                            |                            |
| State appropriations                                    | 319,859                    | 314,294                    | 287,897                    |
| Capital appropriations                                  | -                          | 475                        | 732                        |
| Capital grants and gifts                                | 23,536                     | 63,188                     | 18,915                     |
| Gifts and grants  | 34,218                     | 32,135                     | 24,638                     |
| Investment income                                       | 160,975                    | 119,067                    | 56,517                     |
| Interest on capital asset - related debt                | (12,723)                   | (13,497)                   | (13,062)                   |
| Additions to permanent endowments                       | 29,931                     | 24,336                     | 33,650                     |
| Transfer of net assets of Lexington Community College   | -                          | -                          | (4,968)                    |
| Other, net  | (6,948)                    | 6,025                      | 1,587                      |
| Total nonoperating revenues (expenses)                  | <u>548,848</u>             | <u>546,023</u>             | <u>405,906</u>             |
| Total increase in net assets                            | <u>175,549</u>             | <u>238,946</u>             | <u>124,679</u>             |
| Net assets, beginning of year                           | <u>2,102,102</u>           | <u>1,863,156</u>           | <u>1,738,477</u>           |
| Net assets, end of year                                 | <u><u>\$ 2,277,651</u></u> | <u><u>\$ 2,102,102</u></u> | <u><u>\$ 1,863,156</u></u> |

Total operating revenues were \$1.44 billion for the year ended June 30, 2007, an increase of \$102.8 million (8 percent). The primary components of operating revenues were student tuition and fees of \$166.7 million; grants, contracts and recoveries of facilities and administrative costs of \$342.0 million; hospital services of \$579.2 million; and professional clinical fee income of \$164.4 million.

The major increase was in hospital services revenue of \$58.9 million, caused almost exclusively by an increase in patient volume, due to growth from strategic initiatives in certain product lines and an enhanced outreach network. Additional significant increases in operating revenues related to student tuition and fees, net, of \$19.5 million due to tuition increases of approximately 12 percent and an overall enrollment increase, and of \$14.2 million in professional clinical service fees due to increased patient volume.



Operating expenses totaled \$1.81 billion, an increase of \$169.1 million (10 percent). Of this amount, \$940.3 million was expended for educational and general programs, including the functions of instruction, research and public service. Hospital expenses, excluding depreciation, amounted to \$544.9 million and clinical operations expenses, excluding depreciation, were \$133.3 million. Depreciation expense for the year amounted to \$90.3 million.



The most significant increase was in educational and general expenses, excluding depreciation, of \$75.5 million (9 percent) due primarily to increases in instruction, research and public service. Hospital expenses, excluding depreciation, increased \$69.1 million (15 percent) due to increased usage of medical supplies and increased personnel costs due to higher utilization.

The net loss from operations for the year amounted to \$373.3 million. Nonoperating revenues, net of expenses, amounted to \$548.8 million, resulting in an increase in net assets of \$175.5 million for the year. Nonoperating revenues include state appropriations of \$319.9 million, which increased \$5.6 million, and investment income of \$161.0 million, which increased \$41.9 million in the current year.

**2006 Versus 2005.** Total operating revenues were \$1.33 billion for the year ended June 30, 2006, including student tuition and fees of \$147.3 million (11 percent), grants, contracts and recoveries of facilities and administrative costs of \$340.7 million (26 percent), professional clinical service fees of \$150.2 million (11 percent) and hospital services of \$520.3 million (39 percent). Operating revenues for fiscal 2006 increased by \$145.5 million or 12 percent over fiscal 2005, primarily due to increases in hospital services revenues of \$79.7 million, in grants, contracts and recoveries of facilities and administrative costs of approximately \$32.1 million and in student tuition and fees of \$13.9 million.

Operating expenses totaled \$1.64 billion. Of this amount, \$864.8 million, or 53 percent, was expended for educational and general programs, including the functions of instruction, research and public service. Hospital expenses, excluding depreciation, amounted to \$475.8 million, or 29 percent of the total expenses and clinical operations expenses, excluding depreciation, were \$119.9 million, or 7 percent. Depreciation amounted to \$83.8 million, or 5 percent. Operating expenses for fiscal 2006 increased by \$171.4 million or 12 percent over fiscal 2005, primarily due to increases in hospital expenses, excluding depreciation, of \$88.1 million (23 percent) due to increased usage of medical supplies and increased personnel costs due to higher utilization. Educational and general expenses increased \$67.7 million (8 percent) due primarily to increases in instruction, research and public service.

The net loss from operations for the year amounted to \$307.1 million. Nonoperating revenues, net of expenses, amounted to \$546.0 million, resulting in an increase in net assets of \$238.9 million for the year. This compares with an increase in net assets for fiscal 2005 of \$124.7 million. The most significant difference between fiscal 2005 and 2006 was an increase in non-operating revenue of \$140.1 million due primarily to increases in state appropriations, capital grants and gifts, and investment income.

### **Consolidated Statement of Cash Flows**

The Consolidated Statement of Cash Flows details how cash has increased (or decreased) during the year ended June 30, 2007, with comparative financial information for the year ended June 30, 2006. It breaks out the sources and uses of cash into the following categories:

- Operating activities
- Noncapital financing activities
- Capital financing activities
- Investing activities

Cash flows associated with the University's expendable net assets appear in the operating and noncapital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt, and debt repayments. Purchases and sales of investments are reflected in investing activities.

The primary purpose of the Consolidated Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the University during the year that will allow financial statement readers to assess the institutions:

- Ability to generate future net cash flows,
- Ability to meet obligations as they become due, and
- The possible need for external financing.

A comparative summary of the University's consolidated statement of cash flows for the years ended June 30, 2007, 2006 and 2005 is as follows:

**Condensed Consolidated Statements of Cash Flows (in thousands)**

|   | <u>2007</u>              | <u>2006</u>              | <u>2005</u>              |
|---|--------------------------|--------------------------|--------------------------|
| <b>CASH PROVIDED (USED) BY:</b>                         |                          |                          |                          |
| Operating activities                                    | \$ (255,774)             | \$ (228,971)             | \$ (203,467)             |
| Noncapital financing activities                         | 383,141                  | 373,395                  | 345,427                  |
| Capital and related financing activities                | (159,328)                | 16,357                   | (118,891)                |
| Investing activities                                    | <u>5,649</u>             | <u>(58,921)</u>          | <u>15,696</u>            |
| Net increase (decrease) in cash<br>and cash equivalents | (26,312)                 | 101,860                  | 38,765                   |
| <b>Cash and cash equivalents, beginning of year</b>     | <u>541,715</u>           | <u>439,855</u>           | <u>401,090</u>           |
| <b>Cash and cash equivalents, end of year</b>           | <u><u>\$ 515,403</u></u> | <u><u>\$ 541,715</u></u> | <u><u>\$ 439,855</u></u> |

The University's cash and cash equivalents decreased \$26.3 million in 2007. Total cash provided by operating and non-capital financing activities was \$127.4 million, down \$17.0 million compared to 2006. Total cash used by capital financing activities was \$159.3 million, reflecting both capital funding sources (debt proceeds) and uses (purchases of capital assets and debt service). Total cash provided by investing activities was \$5.6 million.

Major sources of cash received from operating activities are student tuition and fees of \$166.0 million, hospital services of \$573.1 million, grants, contracts and recoveries of facilities and administrative costs of \$328.1 million and professional clinical service fees of \$168.5 million. Major uses of cash for operating activities were payments to employees for salaries and benefits of \$1.08 billion and to vendors and contractors of \$572.0 million.

Noncapital financing activities includes state appropriations from the Commonwealth of Kentucky of \$319.9 million.

Capital and related financing activities include proceeds of capital debt of \$107.9 million and capital grants and gifts of \$19.4 million. Cash of \$175.8 million was expended for construction and acquisition of capital assets, \$83.0 million was used for refunding bonds, and \$36.6 million was expended for principal and interest payments on debt.

Investing activities include proceeds from sales and maturities of investments of \$1.95 billion and interest and dividends on investments of \$48.9 million. Cash of \$1.99 billion was used to purchase investments.

**2006 Versus 2005.** Cash balances improved when comparing fiscal 2006 versus fiscal 2005 with a net increase in cash of approximately \$101.9 million. The net increase in cash was due primarily to the increased funding provided by capital and related financing activities of \$135.2 million.

## Capital Asset and Debt Administration

### Capital Assets

Capital assets, net of accumulated depreciation, totaled \$1.21 billion at June 30, 2007, an increase of \$127.5 million. Capital assets as of June 30, 2007 and significant changes in capital assets during the years ended June 30, 2007 and 2006 are as follows (in millions):

|  | Balance<br>June 30, 2005 | Net<br>Additions<br>FY 05-06 | Balance<br>June 30, 2006 | Net<br>Additions<br>FY 06-07 | Balance<br>June 30, 2007 |
|--|--------------------------|------------------------------|--------------------------|------------------------------|--------------------------|
| Land and land improvements                       | \$ 98                    | \$ 14                        | \$ 112                   | \$ 16                        | \$ 128                   |
| Buildings, fixed equipment<br>and infrastructure | 1,210                    | 67                           | 1,277                    | 58                           | 1,335                    |
| Equipment, vehicles and<br>capitalized software  | 401                      | 41                           | 442                      | 54                           | 496                      |
| Library materials and art                        | 132                      | 6                            | 138                      | 5                            | 143                      |
| Construction in progress                         | 55                       | (12)                         | 43                       | 61                           | 104                      |
| Accumulated depreciation                         | <u>(868)</u>             | <u>(63)</u>                  | <u>(931)</u>             | <u>(66)</u>                  | <u>(997)</u>             |
| Total  | <u>\$ 1,028</u>          | <u>\$ 53</u>                 | <u>\$ 1,081</u>          | <u>\$ 128</u>                | <u>\$ 1,209</u>          |

At June 30, 2007, the University has capital construction projects in progress totaling approximately \$664 million in scope. Major projects include the new hospital patient care facility, the Biological Pharmaceutical Research building, the new student health facility, and the expansion and upgrade of the Livestock Disease Diagnostic Center. The estimated cost to complete these projects is approximately \$514 million.

### Debt

At June 30, 2007, capital debt amounted to \$537.5 million, summarized by trust indenture and type as follows (in millions):

|   | 2007            | 2006            | 2005            |
|---|-----------------|-----------------|-----------------|
| General Receipts bonds and notes                        | \$ 207.3        | \$ 114.7        |                 |
| Consolidated Educational Buildings Revenue Bonds        | 126.2           | 139.2           | \$ 141.6        |
| Housing and Dining System Revenue Bonds                 | -               | 74.0            | 77.0            |
| Hospital Revenue Bonds                                  | -               | -               | 1.8             |
| Commonwealth Library Project (W.T. Young Library) Bonds | 39.0            | 40.2            | 41.4            |
| Capital lease obligations                               | 143.4           | 65.2            | 66.1            |
| Notes payable   | 21.6            | 3.4             | 3.1             |
| Total   | <u>\$ 537.5</u> | <u>\$ 436.7</u> | <u>\$ 331.0</u> |

Debt increased \$100.8 million during the year primarily due to the issuance of bonds for the construction of the Student Health Facility, and capital leases for the purchase of land, buildings, equipment and computer software.

### **Economic Factors That Will Affect the Future**

Executive management believes that the University is well-positioned to maintain its strong financial condition and to continue providing excellent service to students, patients, the community and the Commonwealth of Kentucky. The University's strong financial condition, as evidenced by the receipt of credit ratings of Aa3 and AA- from Moody's Investors Service and Standard & Poor's Ratings Services, respectively, will provide a high degree of flexibility in obtaining funds on competitive terms. This flexibility, along with ongoing efforts toward revenue diversification and cost containment, will enable the University to obtain the necessary resources to sustain excellence. The following are known facts and circumstances that will affect future financial results:

- As a result of an improving economy, budgeted state appropriations will increase by \$16 million to \$335 million for fiscal year 2007-08.
- Tuition rates for fiscal year 2008 will increase an average of approximately 9.0 percent for resident undergraduate students and 6.6 percent for non-resident undergraduate students. The tuition rate increases are expected to generate additional operating revenues of approximately \$16.5 million.
- As of June 30, 2007, grants and contracts of approximately \$390 million have been awarded to the University, but not expended. These contracts will provide grant revenue to future periods.
- A new hospital patient care facility with an estimated construction project cost of \$450 million has been approved by the General Assembly and construction is under way. General Receipts Notes in the amount of \$107.5 million have been issued to provide initial funding for this project. An additional \$150 million in related bond authority has been approved for the current biennium and the University anticipates issuing bonds in this amount during fiscal year 2007-08.
- On July 1, 2007, the University purchased Good Samaritan Hospital, a 336 bed community hospital located in Lexington, Kentucky, contiguous to the University campus. The purchase price, exclusive of direct transaction costs, was approximately \$13,000,000. This acquisition greatly expands the patient care opportunities available for the University to serve the Commonwealth.
- The University will continue its long-term endowment investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to insulate programs funded by the endowment from temporary market volatility.
- The University does not record a liability for post-employment retiree health benefits. Governmental Accounting Standards require that this liability be recognized in the financial statements beginning June 30, 2008. The impact of implementing this change from a cash basis to an accrual basis for recognizing the cost of post-employment retiree health benefits will increase the annual expense associated with providing this benefit from \$6.4 million to \$13.6 million per year beginning in fiscal year 2008.

Economic challenges will continue to impact the future. However, university management believes that the University of Kentucky will be able to sustain its sound financial position and continue its progress to become one of America's 20 best public research institutions.



**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS**  
**CONSOLIDATED STATEMENTS OF NET ASSETS**  
**JUNE 30, 2007 AND 2006**

|  | 2007             | 2006             |
|--|------------------|------------------|
| <b>ASSETS</b>  |                  |                  |
| <b>Current Assets</b>                                  |                  |                  |
| Cash and cash equivalents                              | \$ 372,287,497   | \$ 369,087,885   |
| Notes, loans and accounts receivable, net              | 205,349,472      | 154,909,270      |
| Investments  | 4,196,757        | 3,099,588        |
| Inventories and other                                  | 26,886,295       | 24,802,495       |
| Total current assets                                   | 608,720,021      | 551,899,238      |
| <b>Noncurrent Assets</b>                               |                  |                  |
| Restricted cash and cash equivalents                   | 143,116,091      | 172,627,182      |
| Endowment investments                                  | 945,305,685      | 767,693,088      |
| Other long-term investments                            | 172,433,672      | 201,137,365      |
| Notes, loans and accounts receivable, net              | 38,181,625       | 35,872,190       |
| Other noncurrent assets                                | 21,154,371       | 1,662,816        |
| Capital assets, net                                    | 1,208,670,346    | 1,081,156,203    |
| Total noncurrent assets                                | 2,528,861,790    | 2,260,148,844    |
| Total assets   | 3,137,581,811    | 2,812,048,082    |
| <b>LIABILITIES</b>                                     |                  |                  |
| <b>Current Liabilities</b>                             |                  |                  |
| Accounts payable and accrued liabilities               | 161,633,804      | 126,320,063      |
| Deferred revenue                                       | 60,285,131       | 57,521,650       |
| Long-term liabilities - current portion                | 78,076,113       | 45,501,341       |
| Total current liabilities                              | 299,995,048      | 229,343,054      |
| <b>Noncurrent Liabilities</b>                          |                  |                  |
| Long-term liabilities                                  | 559,935,302      | 480,602,627      |
| Total liabilities                                      | 859,930,350      | 709,945,681      |
| <b>NET ASSETS</b>                                      |                  |                  |
| <b>Invested in capital assets, net of related debt</b> | 773,961,907      | 763,475,732      |
| <b>Restricted</b>                                      |                  |                  |
| Nonexpendable  |                  |                  |
| Scholarships and fellowships                           | 92,820,528       | 83,311,656       |
| Research   | 210,371,384      | 194,070,426      |
| Instruction  | 63,940,014       | 59,711,569       |
| Academic support                                       | 82,106,259       | 82,115,782       |
| Other  | 5,078,180        | 4,545,612        |
| Total restricted nonexpendable                         | 454,316,365      | 423,755,045      |
| Expendable   |                  |                  |
| Scholarships and fellowships                           | 76,587,645       | 57,540,489       |
| Research   | 99,382,538       | 63,706,209       |
| Instruction  | 58,535,959       | 44,326,525       |
| Academic support                                       | 43,274,887       | 29,671,893       |
| Loans  | 9,455,269        | 8,972,452        |
| Capital projects                                       | 77,426,390       | 76,815,088       |
| Debt service   | 3,623,967        | 4,171,226        |
| Auxiliary  | 4,561,675        | 9,833,881        |
| Other  | 10,968,912       | 12,157,229       |
| Total restricted expendable                            | 383,817,242      | 307,194,992      |
| Total restricted                                       | 838,133,607      | 730,950,037      |
| <b>Unrestricted</b>                                    | 665,555,947      | 607,676,632      |
| Total net assets                                       | \$ 2,277,651,461 | \$ 2,102,102,401 |

**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS**  
**CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**FOR THE YEARS ENDED JUNE 30, 2007 AND 2006**

|   | 2007             | 2006             |
|---|------------------|------------------|
| <b>OPERATING REVENUES</b>   |                  |                  |
| Student tuition and fees  | \$ 224,668,456   | \$ 201,192,585   |
| Less: Scholarship allowances  | (57,926,127)     | (53,925,121)     |
| Net tuition and fees  | 166,742,329      | 147,267,464      |
| Federal grants and contracts  | 170,466,382      | 170,590,760      |
| State and local grants and contracts  | 95,901,471       | 95,222,942       |
| Nongovernmental grants and contracts  | 31,869,123       | 31,547,216       |
| Recoveries of facilities and administrative costs   | 43,791,890       | 43,303,460       |
| Sales and services  | 45,717,176       | 42,023,694       |
| Federal appropriations  | 17,857,797       | 15,683,789       |
| County appropriations   | 12,817,459       | 11,998,193       |
| Professional clinical service fees  | 164,431,689      | 150,240,798      |
| Hospital services   | 579,222,126      | 520,310,461      |
| Auxiliary enterprises:  |                  |                  |
| Housing and dining  | 40,605,278       | 40,781,440       |
| Less: Scholarship allowances  | (4,822,458)      | (4,396,917)      |
| Net housing and dining  | 35,782,820       | 36,384,523       |
| Athletics   | 47,516,947       | 45,062,540       |
| Other auxiliaries   | 21,705,111       | 20,632,796       |
| Other operating revenues  | 1,507,086        | 2,222,388        |
| Total operating revenues  | 1,435,329,406    | 1,332,491,024    |
| <b>OPERATING EXPENSES</b>   |                  |                  |
| Educational and general:  |                  |                  |
| Instruction   | 257,954,660      | 240,101,280      |
| Research  | 242,473,926      | 236,141,392      |
| Public service  | 195,347,405      | 164,011,200      |
| Libraries   | 16,591,647       | 14,866,441       |
| Academic support  | 67,475,522       | 61,655,329       |
| Student services  | 22,836,323       | 21,564,839       |
| Institutional support   | 58,864,836       | 50,213,111       |
| Operations and maintenance of plant   | 55,554,077       | 53,047,615       |
| Student financial aid   | 23,215,661       | 23,242,484       |
| Depreciation  | 61,324,257       | 57,901,456       |
| Total educational and general   | 1,001,638,314    | 922,745,147      |
| Clinical operations (including depreciation of \$1,342,478 in 2007 and \$807,937 in 2006)                                   | 134,613,845      | 120,717,535      |
| Hospital and clinics (including depreciation of \$21,691,682 in 2007 and \$19,210,460 in 2006)                              | 566,605,640      | 494,978,315      |
| Auxiliary enterprises:  |                  |                  |
| Housing and dining (including depreciation of \$3,433,154 in 2007 and \$3,366,341 in 2006)                                  | 38,132,789       | 38,780,215       |
| Athletics (including depreciation of \$2,478,790 in 2007 and \$2,474,802 in 2006)   | 53,792,125       | 47,810,546       |
| Other auxiliaries   | 13,617,266       | 14,075,804       |
| Other operating expenses  | 228,599          | 460,336          |
| Total operating expenses  | 1,808,628,578    | 1,639,567,898    |
| Net loss from operations  | (373,299,172)    | (307,076,874)    |
| <b>NONOPERATING REVENUES (EXPENSES)</b>   |                  |                  |
| State appropriations  | 319,859,256      | 314,293,555      |
| Gifts and grants  | 34,217,737       | 32,134,557       |
| Investment income   | 160,975,415      | 119,066,760      |
| Interest on capital asset-related debt  | (12,722,644)     | (13,497,227)     |
| Other nonoperating revenues and expenses, net   | 3,121,530        | 3,749,372        |
| Net nonoperating revenues (expenses)  | 505,451,294      | 455,747,017      |
| Net income (loss) before other revenues, expenses, gains or losses  | 132,152,122      | 148,670,143      |
| Capital appropriations  | -                | 475,068          |
| Capital grants and gifts  | 23,536,462       | 63,188,237       |
| Additions to permanent endowments, including Research Challenge Trust Funds of \$15,401,331 in 2007 and \$9,076,476 in 2006 | 29,930,763       | 24,335,856       |
| Other, net  | (10,070,287)     | 2,276,607        |
| Total other revenues (expenses)   | 43,396,938       | 90,275,768       |
| <b>INCREASE IN NET ASSETS</b>   | 175,549,060      | 238,945,911      |
| <b>NET ASSETS, beginning of year</b>  | 2,102,102,401    | 1,863,156,490    |
| <b>NET ASSETS, end of year</b>  | \$ 2,277,651,461 | \$ 2,102,102,401 |

**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED JUNE 30, 2007 AND 2006**

|   | 2007             | 2006             |
|---|------------------|------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                  |                  |
| Student tuition and fees  | \$ 166,039,394   | \$ 144,545,367   |
| Grants and contracts  | 285,559,893      | 283,967,680      |
| Recoveries of facilities and administrative costs   | 42,548,136       | 41,178,394       |
| Sales and services  | 45,313,405       | 44,686,045       |
| Federal appropriations  | 15,868,099       | 14,746,791       |
| County appropriations   | 12,449,258       | 12,176,710       |
| Payments to vendors and contractors   | (571,958,331)    | (532,207,183)    |
| Student financial aid   | (23,207,121)     | (23,306,717)     |
| Salaries, wages and benefits  | (1,082,516,038)  | (990,500,114)    |
| Professional clinic service fees  | 168,460,192      | 154,322,459      |
| Hospital services   | 573,080,357      | 511,222,775      |
| Auxiliary enterprise receipts:  |                  |                  |
| Housing and Dining  | 36,011,751       | 36,405,967       |
| Athletics   | 49,920,644       | 46,092,778       |
| Other auxiliaries   | 21,963,117       | 20,003,727       |
| Loans issued to students  | (19,967,396)     | (16,292,186)     |
| Collection of loans to students   | 20,910,174       | 16,844,054       |
| Self insurance receipts   | 39,330,989       | 38,995,996       |
| Self insurance payments   | (36,334,387)     | (35,761,650)     |
| Other operating receipts (payments), net  | 753,747          | 3,908,082        |
| Net cash provided (used) by operating activities  | (255,774,117)    | (228,971,025)    |
| <b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>                                      |                  |                  |
| State appropriations  | 319,859,256      | 314,293,555      |
| Gifts and grants received for other than capital purposes:                                  |                  |                  |
| Gifts received for endowment purposes   | 29,930,763       | 24,335,856       |
| Gifts received for other purposes   | 31,337,959       | 30,353,354       |
| Agency and loan program receipts  | 114,295,027      | 107,162,039      |
| Agency and loan program payments  | (116,061,303)    | (106,656,275)    |
| Other noncapital financing receipts (payments), net   | 3,779,592        | 3,906,093        |
| Net cash provided (used) by noncapital financing activities                                 | 383,141,294      | 373,394,622      |
| <b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>                             |                  |                  |
| Capital grants and gifts  | 19,382,629       | 56,273,834       |
| Purchases of capital assets   | (175,833,565)    | (136,651,651)    |
| Proceeds from capital debt  | 107,885,704      | 128,410,581      |
| Payments to refunding bond agents   | (83,020,792)     | -                |
| Proceeds from sales of capital assets   | 5,241,755        | 10,400,000       |
| Principal paid on capital debt and leases   | (20,373,014)     | (25,758,025)     |
| Interest paid on capital debt and leases  | (16,189,397)     | (15,292,480)     |
| Other capital and related financing receipts (payments), net                                | 3,579,115        | (1,025,361)      |
| Net cash provided (used) by capital and related financing activities                        | (159,327,565)    | 16,356,898       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                  |                  |
| Proceeds from sales and maturities of investments   | 1,945,208,797    | 1,675,818,484    |
| Interest and dividends on investments   | 48,887,958       | 62,359,530       |
| Purchase of investments   | (1,988,447,846)  | (1,797,098,674)  |
| Net cash provided (used) by investing activities  | 5,648,909        | (58,920,660)     |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                                 | (26,311,479)     | 101,859,835      |
| <b>CASH AND CASH EQUIVALENTS, beginning of year</b>   | 541,715,067      | 439,855,232      |
| <b>CASH AND CASH EQUIVALENTS, end of year</b>   | \$ 515,403,588   | \$ 541,715,067   |
| <b>Reconciliation of net loss from operations to net cash used by operating activities:</b> |                  |                  |
| Operating loss  | \$ (373,299,172) | \$ (307,076,874) |
| Adjustments to reconcile net loss to net cash used by operating activities:                 |                  |                  |
| Depreciation expense  | 90,270,361       | 83,760,995       |
| Change in assets and liabilities:   |                  |                  |
| Notes, loans and accounts receivable, net   | (22,749,645)     | (25,801,876)     |
| Inventories and other assets  | (1,869,950)      | (4,576,243)      |
| Accounts payable and accrued liabilities  | 40,374,417       | 12,042,808       |
| Deferred revenue  | 2,763,478        | 10,184,938       |
| Long term liabilities   | 8,736,394        | 2,495,227        |
| <b>Net cash used by operating activities</b>  | \$ (255,774,117) | \$ (228,971,025) |

# UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Reporting Entity

The University of Kentucky (the University) is a component unit of the Commonwealth of Kentucky and is included in the basic financial statements of the Commonwealth. The consolidated financial statements of the University include the operations of the University, its for-profit subsidiary (Kentucky Healthcare Enterprise, Inc.) and its affiliated non-profit corporations (entities for which the University is financially accountable as defined by Statement No. 14 and amended by Statement No. 39 of the Governmental Accounting Standards Board (GASB), and which meet the definition of an affiliated corporation under Kentucky Revised Statute (KRS) section 164A.550) as follows: the University of Kentucky Research Foundation and its for-profit subsidiaries (Kentucky Technology, Inc. and Coldstream Laboratories, Inc.); The Fund for Advancement of Education and Research in the University of Kentucky Medical Center; University of Kentucky Athletic Association; Central Kentucky Management Services, Inc.; University of Kentucky Mining Engineering Foundation, Inc.; University of Kentucky Business Partnership Foundation, Inc.; University of Kentucky Gluck Equine Research Foundation, Inc.; University of Kentucky Humanities Foundation, Inc.; and University of Kentucky Center on Aging Foundation, Inc. The consolidated financial statements also include the operations of Kentucky Medical Services Foundation, Inc. (KMSF), a non-profit entity for which the University is financially accountable as defined by GASB, but which is not an affiliated corporation under KRS.

#### Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB. GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and financial reporting purposes into the following net assets categories:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
  - Nonexpendable* – Net assets subject to externally imposed stipulations that they be maintained permanently by the University. Such assets include the principal of the University's permanent endowment funds.
  - Expendable* – Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net assets whose use by the University is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

## Summary of Significant Accounting Policies

Accrual Basis. The consolidated financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. The University reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

Cash and Cash Equivalents. The University considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Noncurrent cash and cash equivalents includes plant funds allocated for capital projects and endowment fund cash pending transfer to the custodian for investment. Cash and cash equivalents held by the University's endowment fund managers are included in endowment investments.

Inventories. Inventories are stated principally at the lower of average cost or market.

Pooled Endowment Funds. The University employs the total return concept of investment management for setting investment objectives and determining investment performance. This concept recognizes dividends and interest, plus or minus realized and unrealized gains or losses, in determining the total return earned during any particular period. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

The Uniform Management of Institutional Funds Act (UMIFA), as adopted by the Commonwealth of Kentucky, permits the University to appropriate an amount of the realized and unrealized endowment appreciation to support current programs. Accordingly, spendable return from the endowment is determined using the total return philosophy. This philosophy recognizes a prudent amount of realized and unrealized gains as spendable return in addition to traditional yield. Distribution of investment earnings for expenditure by participating funds is supported first by traditional yield earned and, if necessary, a transfer from the endowment of any prior years' accumulated earnings (unexpended traditional yield) or net realized or unrealized gains.

In fiscal years 2006-07 and 2005-06, the University's endowment spending rule provided for annual distributions of 4.50 percent and 4.75 percent, respectively, of the three-year moving average market value of fund units. For the years ended June 30, 2007 and 2006 approximately \$9,445,000 and \$10,498,000, respectively, was transferred from endowment realized and unrealized gains to support current programs in accordance with the University's endowment spending rule. Appreciation on endowments available to support future spending rule distributions amounted to approximately \$211,159,000 at June 30, 2007. The Investment Committee of the University's Board of Trustees has approved a spending rate distribution for future fiscal years of 4.50 percent of the three-year moving average market value of fund units. Additionally, the University assesses eligible endowment accounts with a management fee to support fundraising and endowment administration. The management fee was .50 percent and .75 percent, respectively, of total asset value during the years ended June 30, 2007 and 2006. The Investment Committee has approved a management fee of .50 percent of total asset value for future fiscal years.

Investments. Investments in marketable securities are carried at fair value, as determined by the major securities markets. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income in the Statement of Revenues, Expenses and Changes in Net Assets.

Capital Assets. Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift.

Equipment with a unit cost of \$2,000 or more (\$1,000 for computers) and having an estimated useful life of greater than one year, is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings, 10 – 25 years for land and building improvements and infrastructure, 10 years for library books and 5 – 20 years for equipment.

The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research and public service.

Deferred Revenue. Deferred revenue consists primarily of amounts received from grant and contract sponsors that have not yet been earned under the terms of the agreement. Deferred revenue also includes amounts received in advance of an event, such as advance athletic ticket sales relating to future fiscal years and unearned summer school revenue.

Student Tuition and Fees. Student tuition and fees are presented net of scholarship allowances applied to student accounts. Stipends and other payments made directly to students are presented as student financial aid expenses.

Hospital and Clinical Services Revenues. Hospital and clinical services revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including contractual allowances and estimated retroactive adjustments under reimbursement programs with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Income Taxes. The University is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.100 through 164.280. Accordingly, the University is excluded from Federal income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986. Each of the University's affiliated non-profit organizations has received a determination from the Internal Revenue Service granting exemption from federal income taxation pursuant to the provisions of Internal Revenue Code section 501(c)(3). KMSF is also a not-for-profit corporation as described in Section 501 (c)(3) of the Internal Revenue Code.

Restricted Asset Spending Policy. The University's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination on whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

Operating Activities. The University defines operating activities, as reported on the Statement of Revenues, Expenses and Changes in Net Assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for goods and services received. Nearly all of the University's expenses are from exchange transactions. Certain significant revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as non-operating revenues, in accordance with GASB Statement No. 35.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to use estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The accompanying financial statements include estimates for items such as bad debt and contractual allowances, self-insurance reserves, accrued expenses and other liability accounts.

Recent Accounting Pronouncements. In June 2004, the GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions." This statement establishes standards for the measurement, recognition and display of other post employment benefit expenses/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of employers subject to governmental accounting standards.

Statement No. 45 requires employers to record, as the annual cost of the plan, the actuarially determined annual required contribution. The annual required contribution is calculated to include the normal annual cost for the year for current employees plus a component to amortize the unfunded actuarial accrued liabilities of the plan over a period not to exceed 30 years.

The provisions of this statement are effective for financial statements for fiscal periods beginning after December 15, 2006. The impact of implementing this change in the method of recognizing the cost for post employment retiree health benefits will increase the annual expense associated with providing this benefit from \$6.4 million to \$13.6 million per year beginning in fiscal year 2008.

## 2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2007 and 2006 is as follows (in thousands):

|  | <u>2007</u>         | <u>2006</u>         |
|--|---------------------|---------------------|
| Deposits with banks and the Commonwealth of Kentucky | \$ 48,576           | \$ 45,631           |
| U.S. Treasury fixed income securities                | 30,537              | 37,201              |
| Government agency fixed income securities            | 79,753              | 94,973              |
| Common and preferred stocks                          | 92,083              | 66,858              |
| Pooled equity funds                                  | 582,392             | 476,257             |
| Private equity                                       | 8,524               | 2,426               |
| Pooled real estate funds                             | 73,433              | 53,602              |
| Pooled fixed income funds                            | 481,270             | 510,613             |
| Corporate fixed income securities                    | 29,369              | 25,626              |
| Guaranteed investment contracts                      | 10,545              | 13,487              |
| Repurchase agreements                                | 144,437             | 142,705             |
| Certificates of deposit                              | 22,254              | 19,263              |
| Cash and cash equivalents                            | 33,944              | 24,855              |
| Other  | 223                 | 148                 |
| Total  | <u>\$ 1,637,340</u> | <u>\$ 1,513,645</u> |

|  | <u>2007</u>         | <u>2006</u>         |
|--|---------------------|---------------------|
| Statement of Net Assets classification |                     |                     |
| Cash and cash equivalents              | \$ 372,287          | \$ 369,088          |
| Current investments                    | 4,197               | 3,100               |
| Restricted cash and cash equivalents   | 143,116             | 172,627             |
| Endowment investments                  | 945,306             | 767,693             |
| Other long-term investments            | 172,434             | 201,137             |
| Total                                  | <u>\$ 1,637,340</u> | <u>\$ 1,513,645</u> |

During fiscal 2006, the University sold its approximately 84 percent ownership of CHA Service Company (CHA), a Kentucky for-profit corporation established to provide an integrated health care delivery system throughout the Commonwealth of Kentucky, at a gain of approximately \$28.8 million. The University accounted for its investment in CHA by the equity method since, under the provision of CHA's by-laws, the University could not exercise control over the day-to-day operations of CHA. A summary of the University's investment in CHA is as follows (in thousands):

|   | June 30,<br>2005 | Fiscal<br>2005-06  | June 30,<br>2006 |
|---|------------------|--------------------|------------------|
| Capital investment  | \$ 38,180        |                    | \$ 38,180        |
| Equity in income (losses) through December 31<br>(CHA fiscal year end) and date of sale | (7,885)          | \$ 11,731          | 3,846            |
| Cash dividend   | -                | (25,148)           | (25,148)         |
| Sale proceeds   | -                | (45,714)           | (45,714)         |
| Gain on sale  | -                | 28,836             | 28,836           |
| Net investment  | <u>\$ 30,295</u> | <u>\$ (30,295)</u> | <u>\$ -</u>      |

As part of the CHA sales agreement, escrow funds were established totaling \$9.5 million to cover any potential unrecorded liabilities or overstatement of asset value and for any additional transaction costs. Monies remaining in these escrow accounts as of August 2007 were to be returned to the Hospital in proportion to its prior ownership interest in CHA. The Hospital recorded, and included in the gain above, a receivable of \$3.75 million, as of June 30, 2006, for its estimated share of these escrow funds. The actual amount distributed in August 2007 was approximately \$7.4 million, resulting in an addition gain on sale of \$3.65 million, which was recorded in income of fiscal year 2007 along with an additional \$1.4 million adjustment to the purchase price in January 2007. The total gain recognized on this sale amounts to approximately \$33.9 million.

**Deposit and investment policies.** The University's Board of Trustees is responsible for establishing deposit and investment policies. Once established, the Board has delegated day-to-day management to the Treasurer of the University, who is also the Treasurer of the Board. Deposit and investment policies are developed to insure compliance with state laws and regulations as well as to establish and maintain sound financial management practices.

The University follows Kentucky Revised Statutes (KRS 42.500) for the investment of public funds, which list allowable investment instruments to include: obligations of the United States or a United States government agency; obligations of any corporation of the United States Government; collateralized certificates of deposit; highly rated uncollateralized certificates of deposit, bankers acceptances and commercial paper; highly rated securities issued by a state or local government; and mutual funds comprised of any of the above allowable investments.

For purposes of investment management, the majority of the University's deposits and investments can be grouped into five significant categories, as follows:

- Overnight investments (deposits and repurchase agreements) with local banks and the Commonwealth of Kentucky;
- Bond revenue fund investments held by the Treasurer of the Commonwealth of Kentucky as required by the University's bond trust indentures, and invested in pooled fixed income funds managed by the Commonwealth of Kentucky;
- Short-term investments managed by the University, including individual securities purchased and held by the University and short-term investments in pooled fixed income funds managed by the Commonwealth of Kentucky;
- Debt service reserve fund investments required by the University's bond trust indentures and held by the bond trustees;
- Endowment investments administered by the University and managed using external investment managers.



The Treasurer manages the overnight and short-term investment programs of the University based on the Statement of Investment Objectives and Policies for Short-Term Current Funds Investments established by the Investment Committee of the University's Board of Trustees.

The University's policy for the investment of bond revenue and debt service reserve funds is governed by each respective bond's trust indenture.

The Investment Committee of the University's Board of Trustees establishes and maintains the University's Endowment Investment Policies.

**Deposit and investment risks.** The University's deposits and investments are exposed to various risks, including credit, interest rate and foreign currency risk, as discussed in more detail below:

**Credit Risk.** Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing the University to experience a loss of principal.

As a means of limiting its exposure to losses arising from credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Overnight investment (deposits and repurchase agreements) policies minimize credit risk in several ways. Deposits are governed by state law which requires full collateralization. Credit risk on repurchase agreements with local banks is mitigated by the issuing financial institution's pledge of specific U.S. treasury or agency securities, held in the name of the University by the Federal Reserve Bank. Credit risk on repurchase agreements with the Commonwealth of Kentucky is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth.
- Bond revenue fund investments held in the Commonwealth's investment pools can invest in U.S. treasuries and agencies; commercial paper or asset backed securities rated in the highest category by a nationally recognized rating agency; certificates of deposit, bankers acceptances, state or local government securities and corporate, Yankee and Eurodollar securities rated in one of the three highest categories by a nationally recognized rating agency; shares of mutual funds (up to 10%); and state and local property tax certificates of delinquency secured by interests in real estate.
- Short-term investments managed by the University are limited to direct obligations of the U.S. Treasury, other appropriate securities issued by federal agencies, repurchase agreements of U.S. government obligations, and certificates of deposit collateralized by U.S. government obligations or general obligations of the University of Kentucky. Short-term investments held in the Commonwealth's investment pools are subject to the same credit quality requirements as denoted above for bond revenue fund investments.
- Investment securities held in bond debt service reserve funds may be invested and reinvested solely in bonds or interest bearing notes of the United States Government.
- Endowment investments held by fixed income managers are generally limited to holdings of high quality fixed income securities. These managers may invest a portion of the portfolio in other below-investment grade bonds, non-U.S. dollar denominated bonds, and emerging market bonds, provided the overall credit quality of the fixed income portfolios is not lower than A-.

At June 30, 2007, the credit quality of the University's fixed income investments is as follows (in thousands):

|                                       | <u>S&amp;P/Moody's Credit Ratings</u> |                 |                 |                 |                   | Rating           |                   |
|---------------------------------------|---------------------------------------|-----------------|-----------------|-----------------|-------------------|------------------|-------------------|
|                                       | AAA/Aaa                               | AA/Aa           | A               | BBB/Baa         | Not rated         | Not Applicable   | Total             |
| U.S. Treasury fixed income            |                                       |                 |                 |                 |                   | \$ 30,537        | \$ 30,537         |
| Government agency fixed income        | \$ 78,147                             |                 |                 |                 | \$ 1,606          | -                | 79,753            |
| Pooled fixed income                   | 641                                   | \$ 1,919        |                 |                 | 478,710           | -                | 481,270           |
| Corporate fixed income                | 20,267                                | -               | \$ 448          | \$ 8,654        | -                 | -                | 29,369            |
| Guaranteed investment contracts       | -                                     | -               | -               | -               | 10,545            | -                | 10,545            |
| Repurchase agreements                 | -                                     | -               | -               | -               | 139,493           | 4,944            | 144,437           |
| Certificates of deposit               | -                                     | -               | -               | -               | 22,254            | -                | 22,254            |
| Cash and cash equivalents             | 28,745                                | -               | 2,160           | -               | 3,025             | 14               | 33,944            |
| <b>Total fixed income investments</b> | <b>\$ 127,800</b>                     | <b>\$ 1,919</b> | <b>\$ 2,608</b> | <b>\$ 8,654</b> | <b>\$ 655,633</b> | <b>\$ 35,495</b> | <b>\$ 832,109</b> |

**Custodial Credit Risk.** Custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investment or collateral securities that are in possession of an outside party.

As a means of limiting its exposure to losses arising from custodial credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Overnight investments (deposits and repurchase agreements) are not exposed to custodial credit risk other than repurchase agreements with the Commonwealth of Kentucky which are held in the Commonwealth's name.
- Bond revenue fund investments and short-term investments held in the Commonwealth's investment pools are held in the Commonwealth's name by the Commonwealth's custodian.
- Short-term investments managed by the University are held in the University's name by the University's custodian.
- Investment securities held in bond debt service reserve funds are held by the respective bond trustee in a specific trust account for the benefit of the University and bondholders.
- Endowment investments are held in the University's name by the University's custodian.

At June 30, 2007, the following University deposit and investment balances held in the name of the Commonwealth of Kentucky, included in the above significant investment types, were exposed to custodial credit risk as follows (in thousands):

|  | State Deposits   | Overnight Investments | Bond Revenue Investments | Short-term Investments | Other State Investments | Total             |
|--|------------------|-----------------------|--------------------------|------------------------|-------------------------|-------------------|
| Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the University's name | \$ 40,987        | \$ 110,000            |                          |                        |                         | \$ 150,987        |
| Uninsured, not registered in the name of the University and held by the counterparty but not in the University's name                                | -                | -                     | \$ 232,343               | \$ 59,434              | 93,507                  | 385,284           |
| <b>Total</b>   | <b>\$ 40,987</b> | <b>\$ 110,000</b>     | <b>\$ 232,343</b>        | <b>\$ 59,434</b>       | <b>\$ 93,507</b>        | <b>\$ 536,271</b> |

**Concentrations of Credit Risk.** University investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer.

As a means of limiting its exposure to concentrations of credit risk, the University's investment policies limit concentrations in various investment types, as follows:

- Overnight investments (deposits and repurchase agreements) are not limited as to the maximum amount that may be invested in one issuer. However, all such investments in excess of Federal Depository Insurance are required to be fully collateralized by U.S. treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- Bond revenue fund investments and short-term investments held in the Commonwealth's investment pools are limited as follows: U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers shall not exceed twenty-five (25) percent of an individual pool and \$25,000,000 per issuer, inclusive of commercial paper, bankers' acceptances and certificates of deposit; and U. S. dollar denominated sovereign debt shall not exceed five (5) percent of any individual portfolio and \$25,000,000 per issuer.
- There is no specific limit on the maximum amount of short-term investments managed by the University that may be invested in one issuer. However, such investments are limited to direct U.S. government obligations (U.S. Treasuries) and U.S. government agencies.
- There is no specific limit on the maximum amount of investment securities held in bond debt service reserve funds that may be invested in one issuer. However, such investments are limited to bonds or interest bearing notes of the U.S. government.
- Endowment investment managers are limited to a maximum investment in any one issuer of no more than five (5) percent of total investments.

At June 30, 2007, the University has no investments in any one issuer, other than U.S. treasury and/or agency securities, that represent 5 percent or more of total investments.

**Interest Rate Risk.** Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Overnight investments (deposits and repurchase agreements) have limited exposure to interest rate risk due to the short-term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Bond revenue fund investments and short-term investments held in the Commonwealth's short-term investment pool are limited to a duration that does not exceed 90 days. Such investments in the Commonwealth's intermediate-term investment pool must maintain a modified duration of less than 3 years.
- Short-term investments managed by the University are limited to a maximum maturity of 24 months.
- Investment securities held in bond debt service reserve funds are required to have a maturity no later than two years from the date of the investment.
- Endowment investments held by fixed income managers are limited to a duration that is within +/-25 percent of the duration of the Lehman Aggregate Bond Index.

Below is the maturity distribution of the University's fixed income investments at June 30, 2007 (in thousands):

| Investment Type                 | Maturities in Years |                 |               |                 |                 | Managed based on duration | Total             |
|---------------------------------|---------------------|-----------------|---------------|-----------------|-----------------|---------------------------|-------------------|
|                                 | Less than 1         | 1-3             | 3-5           | 5-10            | Greater than 10 |                           |                   |
| U.S. Treasury fixed income      | \$ 10,483           | \$ 976          |               | \$ 71           | \$ 42           | \$ 18,965                 | \$ 30,537         |
| Government agency fixed income  | 36,085              | 2,317           | \$ 498        | 432             | 1,369           | 39,052                    | 79,753            |
| Pooled fixed income             | -                   | -               | -             | -               | -               | 481,270                   | 481,270           |
| Corporate fixed income          | -                   | -               | -             | 433             | 160             | 28,776                    | 29,369            |
| Guaranteed investment contracts | 2,611               | 4,248           | 150           | 361             | 3,175           | -                         | 10,545            |
| Repurchase agreements           | 139,493             | -               | -             | 1,008           | 3,936           | -                         | 144,437           |
| Certificates of deposit         | 22,254              | -               | -             | -               | -               | -                         | 22,254            |
| Cash and cash equivalents       | 33,944              | -               | -             | -               | -               | -                         | 33,944            |
| Total fixed income investments  | <u>\$ 244,870</u>   | <u>\$ 7,541</u> | <u>\$ 648</u> | <u>\$ 2,305</u> | <u>\$ 8,682</u> | <u>\$ 568,063</u>         | <u>\$ 832,109</u> |

At June 30, 2007, the University had the following investments managed based on duration (in thousands):

| Investment Type                            | Fair Value        | Modified Duration (Years) |
|--|-------------------|---------------------------|
| U.S. Treasury fixed income securities      |                   |                           |
| Pooled endowment fund                      | \$ 18,965         | 7.17                      |
| Government agency fixed income securities  |                   |                           |
| Pooled endowment fund                      | 39,052            | 4.11                      |
| Pooled fixed income funds                  |                   |                           |
| Pooled endowment fund                      | 93,426            | 4.66                      |
| Other endowment investments                | 2,560             | 3.55                      |
| Commonwealth of Kentucky short-term pool   | 219,006           | 0.06                      |
| Commonwealth of Kentucky intermediate pool | 166,278           | 1.18                      |
| Corporate fixed income securities          |                   |                           |
| Pooled endowment fund                      | <u>28,776</u>     | 2.94                      |
| Total                                      | <u>\$ 568,063</u> |                           |

**Foreign Currency Risk.** Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit.

The University's exposure to foreign currency risk derives from certain limited endowment investments, including pooled fixed income funds, a pooled global equity fund, and pooled non-U.S. equity funds. The University's endowment investment policy allows fixed-income managers to invest a portion of their funds in non-U.S. securities and equity fund managers of co-mingled portfolios to invest in accordance with the guidelines established in the individual fund's prospectus.

At June 30, 2007, the following endowment investments were subject to foreign currency risk (in thousands):

| Endowment Investments        | Fair Value        |
|------------------------------|-------------------|
| Pooled fixed income funds    | \$ 11,857         |
| Pooled global equity fund    | 75,411            |
| Pooled non-U.S. equity funds | <u>106,623</u>    |
|                              | <u>\$ 193,891</u> |

### 3. NOTES, LOANS AND ACCOUNTS RECEIVABLE, NET

Notes, loans and accounts receivable as of June 30, 2007 and 2006, respectively, are as follows (in thousands):

|   | 2007                |                    |                   |
|---|---------------------|--------------------|-------------------|
|   | Gross<br>Receivable | Allowance          | Net<br>Receivable |
| Hospital patient accounts                         | \$ 84,501           | \$ (18,416)        | \$ 66,085         |
| KMSF patient accounts                             | 21,734              | (3,337)            | 18,397            |
| Dentistry patient accounts                        | 3,491               | (848)              | 2,643             |
| KMSF receivable - Good Samaritan transaction      | 18,669              | -                  | 18,669            |
| Student loans                                     | 25,592              | (2,426)            | 23,166            |
| Reimbursement receivable - grants and contracts   | 56,166              | -                  | 56,166            |
| Reimbursement receivable - federal appropriations | 3,915               | -                  | 3,915             |
| Pledges receivable                                | 32,061              | (12,095)           | 19,966            |
| Accrued interest receivable                       | 5,863               | -                  | 5,863             |
| Student receivables                               | 7,957               | (2,278)            | 5,679             |
| Escrow funds receivable - CHA sale                | 7,400               | -                  | 7,400             |
| Other   | 16,547              | (965)              | 15,582            |
| Total   | <u>\$ 283,896</u>   | <u>\$ (40,365)</u> | <u>\$ 243,531</u> |
| Current portion                                   |                     |                    | \$ 205,349        |
| Noncurrent portion                                |                     |                    | <u>38,182</u>     |
| Total   |                     |                    | <u>\$ 243,531</u> |
|   | 2006                |                    |                   |
|   | Gross<br>Receivable | Allowance          | Net<br>Receivable |
| Hospital patient accounts                         | \$ 68,087           | \$ (13,900)        | \$ 54,187         |
| KMSF patient accounts                             | 24,015              | (6,151)            | 17,864            |
| Dentistry patient accounts                        | 2,936               | (664)              | 2,272             |
| Student loans                                     | 26,696              | (2,494)            | 24,202            |
| Reimbursement receivable - grants and contracts   | 49,167              | -                  | 49,167            |
| Reimbursement receivable - federal appropriations | 1,797               | -                  | 1,797             |
| Pledges receivable                                | 23,638              | (8,359)            | 15,279            |
| Accrued interest receivable                       | 4,215               | -                  | 4,215             |
| Student receivables                               | 8,090               | (2,191)            | 5,899             |
| Escrow funds receivable - CHA sale                | 3,750               | -                  | 3,750             |
| Other   | 12,809              | (660)              | 12,149            |
| Total   | <u>\$ 225,200</u>   | <u>\$ (34,419)</u> | <u>\$ 190,781</u> |
| Current portion                                   |                     |                    | \$ 154,909        |
| Noncurrent portion                                |                     |                    | <u>35,872</u>     |
| Total   |                     |                    | <u>\$ 190,781</u> |

#### 4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2007, and capital asset activity for the year ended June 30, 2007, are summarized as follows (in thousands):

|                                    | June 30, 2006       | Additions         | Deletions        | June 30, 2007       |
|------------------------------------|---------------------|-------------------|------------------|---------------------|
| Land                               | \$ 44,681           | \$ 14,505         | \$ 982           | \$ 58,204           |
| Land improvements - nonexhaustible | 16,291              | 808               | -                | 17,099              |
| Land improvements - exhaustible    | 51,070              | 1,342             | 28               | 52,384              |
| Buildings                          | 1,184,627           | 67,953            | 15,805           | 1,236,775           |
| Fixed equipment - communications   | 44,473              | 3,866             | -                | 48,339              |
| Infrastructure                     | 47,954              | 2,166             | -                | 50,120              |
| Equipment                          | 373,354             | 50,881            | 20,062           | 404,173             |
| Vehicles                           | 18,528              | 1,569             | 681              | 19,416              |
| Library materials                  | 124,133             | 4,859             | 379              | 128,613             |
| Nondepreciable library materials   | 6,313               | 68                | -                | 6,381               |
| Capitalized software               | 50,212              | 22,413            | -                | 72,625              |
| Art                                | 7,054               | 251               | -                | 7,305               |
| Construction in progress           | 43,108              | 83,132            | 22,223           | 104,017             |
|                                    | <u>2,011,798</u>    | <u>253,813</u>    | <u>60,160</u>    | <u>2,205,451</u>    |
| <u>Accumulated Depreciation</u>    |                     |                   |                  |                     |
| Land improvements - exhaustible    | 41,935              | 1,621             | 11               | 43,545              |
| Buildings                          | 495,053             | 31,581            | 3,767            | 522,867             |
| Fixed equipment - communications   | 24,124              | 3,405             | -                | 27,529              |
| Infrastructure                     | 10,218              | 1,961             | -                | 12,179              |
| Equipment                          | 242,945             | 36,703            | 19,673           | 259,975             |
| Vehicles                           | 13,641              | 2,234             | 680              | 15,195              |
| Library materials                  | 96,134              | 6,504             | -                | 102,638             |
| Capitalized software               | 6,592               | 6,261             | -                | 12,853              |
|                                    | <u>930,642</u>      | <u>90,270</u>     | <u>24,131</u>    | <u>996,781</u>      |
| Capital assets, net                | <u>\$ 1,081,156</u> | <u>\$ 163,543</u> | <u>\$ 36,029</u> | <u>\$ 1,208,670</u> |

Capital assets as of June 30, 2006, and capital asset activity for the year ended June 30, 2006, are summarized as follows (in thousands):

|                                    | <u>June 30, 2005</u> | <u>Additions</u>  | <u>Deletions</u> | <u>June 30, 2006</u> |
|------------------------------------|----------------------|-------------------|------------------|----------------------|
| Land                               | \$ 39,559            | \$ 5,122          |                  | \$ 44,681            |
| Land improvements - nonexhaustible | 13,128               | 3,195             | \$ 32            | 16,291               |
| Land improvements - exhaustible    | 45,787               | 5,306             | 23               | 51,070               |
| Buildings                          | 1,125,326            | 70,672            | 11,371           | 1,184,627            |
| Fixed equipment - communications   | 40,253               | 4,247             | 27               | 44,473               |
| Infrastructure                     | 44,779               | 3,238             | 63               | 47,954               |
| Equipment                          | 351,879              | 49,686            | 28,211           | 373,354              |
| Vehicles                           | 17,699               | 1,840             | 1,011            | 18,528               |
| Library materials                  | 118,856              | 5,628             | 351              | 124,133              |
| Nondepreciable library materials   | 5,947                | 366               | -                | 6,313                |
| Capitalized software               | 31,465               | 18,747            | -                | 50,212               |
| Art                                | 6,969                | 85                | -                | 7,054                |
| Construction in progress           | 54,802               | 38,571            | 50,265           | 43,108               |
|                                    | <u>1,896,449</u>     | <u>206,703</u>    | <u>91,354</u>    | <u>2,011,798</u>     |
| <u>Accumulated Depreciation</u>    |                      |                   |                  |                      |
| Land improvements - exhaustible    | 39,841               | 2,094             | -                | 41,935               |
| Buildings                          | 464,944              | 30,775            | 666              | 495,053              |
| Fixed equipment - communications   | 21,036               | 3,088             | -                | 24,124               |
| Infrastructure                     | 8,334                | 1,884             | -                | 10,218               |
| Equipment                          | 227,735              | 35,181            | 19,971           | 242,945              |
| Vehicles                           | 13,003               | 1,505             | 867              | 13,641               |
| Library materials                  | 90,228               | 5,906             | -                | 96,134               |
| Capitalized software               | 3,264                | 3,328             | -                | 6,592                |
|                                    | <u>868,385</u>       | <u>83,761</u>     | <u>21,504</u>    | <u>930,642</u>       |
| Capital assets, net                | <u>\$ 1,028,064</u>  | <u>\$ 122,942</u> | <u>\$ 69,850</u> | <u>\$ 1,081,156</u>  |

At June 30, 2007, the University has construction projects in process totaling approximately \$664 million in scope. The estimated cost to complete these projects is approximately \$514 million. Such construction is principally financed by proceeds from the University's general receipts bonds and by capital appropriations from the Commonwealth of Kentucky.

The University has utilized capital leases to acquire various items of equipment costing approximately \$18.3 million. Additionally, the University has entered into capital lease agreements to finance renovations to Commonwealth Stadium and for the construction of several buildings, including the new hospital patient care facility. The University has also utilized capital leases to fund the purchase and implementation of its new administrative computing systems and for the lease purchase of land and buildings associated with its purchase of Good Samaritan Hospital (see note 24).

## 5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2007 and 2006, respectively, are as follows (in thousands):

|   | <u>2007</u>       | <u>2006</u>       |
|---|-------------------|-------------------|
| Payable to vendors and contractors                          | \$ 61,330         | \$ 46,336         |
| Accrued expenses, including vacation and sick leave         | 62,380            | 42,685            |
| Employee withholdings and deposits payable to third parties | <u>37,924</u>     | <u>37,299</u>     |
| Total   | <u>\$ 161,634</u> | <u>\$ 126,320</u> |

## 6. DEFERRED REVENUE

Deferred revenue as of June 30, 2007 and 2006, respectively, is as follows (in thousands):

|                                       | <u>2007</u>      | <u>2006</u>      |
|---------------------------------------|------------------|------------------|
| Unearned summer school revenue        | \$ 4,338         | \$ 4,421         |
| Unearned hospital revenue             | 10,972           | 12,542           |
| Unearned grants and contracts revenue | 29,627           | 28,906           |
| Prepaid athletic ticket sales         | 11,943           | 9,162            |
| Other                                 | <u>3,405</u>     | <u>2,491</u>     |
| Total                                 | <u>\$ 60,285</u> | <u>\$ 57,522</u> |



## 7. LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2007, and long-term liability activity for the year ended June 30, 2007, are summarized as follows (in thousands):

|   | June 30,<br>2006  | Additions         | Reductions        | June 30,<br>2007  | Current<br>Portion | Noncurrent<br>Portion |
|---|-------------------|-------------------|-------------------|-------------------|--------------------|-----------------------|
| <u>Bonds, notes and capital leases</u>            |                   |                   |                   |                   |                    |                       |
| General receipts notes                            | \$ 107,540        | \$ 68,525         | \$ 150            | \$ 175,915        | \$ 2,745           | \$ 173,170            |
| General receipts bonds                            | 7,160             | 24,325            | 245               | 31,240            | 1,040              | 30,200                |
| Educational buildings bonds                       | 139,170           | -                 | 12,945            | 126,225           | 10,520             | 115,705               |
| Housing and dining bonds                          | 74,000            | -                 | 74,000            | -                 | -                  | -                     |
| Library bonds                                     | 40,250            | -                 | 1,215             | 39,035            | 1,265              | 37,770                |
| Capital leases and other<br>long-term obligations | 65,195            | 91,459            | 13,239            | 143,415           | 17,740             | 125,675               |
| Notes payable                                     | 3,408             | 18,659            | 441               | 21,626            | 21,055             | 571                   |
| Total bonds, notes and capital leases             | <u>436,723</u>    | <u>202,968</u>    | <u>102,235</u>    | <u>537,456</u>    | <u>54,365</u>      | <u>483,091</u>        |
| <u>Other liabilities</u>                          |                   |                   |                   |                   |                    |                       |
| Medical malpractice                               | 29,779            | 6,528             | 4,330             | 31,977            | 5,013              | 26,964                |
| Long term disability                              | 10,056            | 1,774             | 2,007             | 9,823             | 1,958              | 7,865                 |
| Annuities payable                                 | 5,937             | 784               | 17                | 6,704             | 621                | 6,083                 |
| Health insurance                                  | 8,458             | 29,654            | 27,208            | 10,904            | 10,904             | -                     |
| Federal loan programs                             | 21,889            | 963               | 958               | 21,894            | -                  | 21,894                |
| Workers compensation                              | 5,276             | 6,785             | 1,985             | 10,076            | 3,016              | 7,060                 |
| Compensated absences                              | 3,250             | 187               | -                 | 3,437             | 490                | 2,947                 |
| Supplemental disability                           | 431               | 178               | 254               | 355               | 229                | 126                   |
| Arbitrage rebate                                  | 365               | 163               | -                 | 528               | 93                 | 435                   |
| Unamortized bond premium                          | 2,182             | 1,701             | 193               | 3,690             | 220                | 3,470                 |
| Outstanding check liability                       | 596               | 644               | 596               | 644               | 644                | -                     |
| Unemployment compensation                         | 455               | 448               | 380               | 523               | 523                | -                     |
| Other   | 707               | -                 | 707               | -                 | -                  | -                     |
| Total other liabilities                           | <u>89,381</u>     | <u>49,809</u>     | <u>38,635</u>     | <u>100,555</u>    | <u>23,711</u>      | <u>76,844</u>         |
| Total   | <u>\$ 526,104</u> | <u>\$ 252,777</u> | <u>\$ 140,870</u> | <u>\$ 638,011</u> | <u>\$ 78,076</u>   | <u>\$ 559,935</u>     |

Long-term liabilities as of June 30, 2006, and long-term liability activity for the year ended June 30, 2006, are summarized as follows (in thousands):

|  | June 30,<br>2005  | Additions         | Reductions       | June 30,<br>2006  | Current<br>Portion | Noncurrent<br>Portion |
|--|-------------------|-------------------|------------------|-------------------|--------------------|-----------------------|
| <u>Bonds, notes and capital leases</u>         |                   |                   |                  |                   |                    |                       |
| General receipts notes                         |                   | \$ 107,540        |                  | \$ 107,540        |                    | \$ 107,540            |
| General receipts bonds                         |                   | 7,160             |                  | 7,160             | \$ 245             | 6,915                 |
| Educational buildings bonds                    | \$ 141,565        | 11,495            | \$ 13,890        | 139,170           | 12,945             | 126,225               |
| Housing and dining bonds                       | 77,055            | -                 | 3,055            | 74,000            | 3,155              | 70,845                |
| Hospital bonds                                 | 1,770             | -                 | 1,770            | -                 | -                  | -                     |
| Library bonds                                  | 41,415            | -                 | 1,165            | 40,250            | 1,215              | 39,035                |
| Capital leases and other long-term obligations | 66,077            | 4,845             | 5,727            | 65,195            | 5,110              | 60,085                |
| Notes payable                                  | 3,104             | 3,017             | 2,713            | 3,408             | 2,608              | 800                   |
| Total bonds, notes and capital leases          | <u>330,986</u>    | <u>134,057</u>    | <u>28,320</u>    | <u>436,723</u>    | <u>25,278</u>      | <u>411,445</u>        |
| <u>Other liabilities</u>                       |                   |                   |                  |                   |                    |                       |
| Medical malpractice                            | 27,964            | 5,067             | 3,252            | 29,779            | 3,396              | 26,383                |
| Long term disability                           | 10,460            | 1,899             | 2,303            | 10,056            | 1,912              | 8,144                 |
| Annuities payable                              | 5,691             | 419               | 173              | 5,937             | 559                | 5,378                 |
| Health insurance                               | 8,614             | 27,176            | 27,332           | 8,458             | 8,458              | -                     |
| Federal loan programs                          | 21,840            | 1,081             | 1,032            | 21,889            | -                  | 21,889                |
| Workers compensation                           | 4,235             | 4,565             | 3,524            | 5,276             | 3,300              | 1,976                 |
| Mining and Minerals Trust                      | 55                | -                 | 55               | -                 | -                  | -                     |
| Compensated absences                           | 3,000             | 250               | -                | 3,250             | 473                | 2,777                 |
| Supplemental disability                        | 342               | 284               | 195              | 431               | 254                | 177                   |
| Arbitrage rebate                               | 365               | 190               | 190              | 365               | -                  | 365                   |
| Unamortized bond premium                       | -                 | 2,267             | 85               | 2,182             | 113                | 2,069                 |
| Outstanding check liability                    | 450               | 596               | 450              | 596               | 596                | -                     |
| Unemployment compensation                      | 419               | 505               | 469              | 455               | 455                | -                     |
| Other  | 1,079             | 377               | 749              | 707               | 707                | -                     |
| Total other liabilities                        | <u>84,514</u>     | <u>44,676</u>     | <u>39,809</u>    | <u>89,381</u>     | <u>20,223</u>      | <u>69,158</u>         |
| Total  | <u>\$ 415,500</u> | <u>\$ 178,733</u> | <u>\$ 68,129</u> | <u>\$ 526,104</u> | <u>\$ 45,501</u>   | <u>\$ 480,603</u>     |

Principal maturities and interest on bonds, notes, capital leases and other long-term obligations for the next five years and in subsequent five-year periods as of June 30, 2007, are as follows (in thousands):

|           | Principal         | Interest          | Total             |
|-----------|-------------------|-------------------|-------------------|
| 2008      | \$ 54,365         | \$ 20,484         | \$ 74,849         |
| 2009      | 33,580            | 18,228            | 51,808            |
| 2010      | 38,888            | 17,003            | 55,891            |
| 2011      | 36,135            | 19,355            | 55,490            |
| 2012      | 65,400            | 19,031            | 84,431            |
| 2013-2017 | 123,768           | 56,533            | 180,301           |
| 2018-2022 | 116,360           | 29,679            | 146,039           |
| 2023-2027 | 68,960            | 6,246             | 75,206            |
| Total     | <u>\$ 537,456</u> | <u>\$ 186,559</u> | <u>\$ 724,015</u> |

At June 30, 2007, assets with a fair market value of approximately \$122,914,000 have been placed on deposit with trustees to totally defease bonds with a par amount of \$114,020,000. The liability for these fully defeased bonds is not included in the financial statements.

On October 5, 2006, the University sold \$77,905,000 of University of Kentucky General Receipts Project Notes, 2007 Series A, at a net interest cost of 4.55 percent. These bonds were sold with a forward delivery date of November 1, 2007. The proceeds of this bond issue will provide additional funding for the construction of the University's new hospital patient care facility.

On October 18, 2006, \$66,305,000 of University of Kentucky General Receipts Project Notes Series 2006A and \$2,220,000 of Series 2006B were issued at a net interest cost of 4.12 percent, representing a full refunding of all Consolidated Housing and Dining System Revenue Bonds (\$74,000,000 par), and a partial refunding of \$6,420,000 of State Properties and Building Commission Project Notes. The refunding will reduce the University's total debt service payments over the next seventeen years by approximately \$635,000, representing an economic gain (difference between the present value of the debt service payments on the old and new debt) of approximately \$646,000.

## 8. COMPONENTS OF RESTRICTED EXPENDABLE NET ASSETS

Restricted expendable net assets are subject to externally imposed stipulations or conditions that must be followed and cannot be used for support of general operations of the University. As of June 30, 2007 and 2006, respectively, restricted expendable net assets were composed of the following (in thousands):

|  | <u>2007</u>       | <u>2006</u>       |
|--|-------------------|-------------------|
| Appreciation on permanent endowments                               | \$ 170,338        | \$ 102,412        |
| Term endowments  | 7,791             | 6,867             |
| Quasi-endowments initially funded with restricted assets           | 43,077            | 43,177            |
| Funds restricted for capital purposes                              | 81,050            | 80,986            |
| Funds restricted for noncapital purposes                           | 72,106            | 64,781            |
| Loan funds (primarily University funds required for federal match) | <u>9,455</u>      | <u>8,972</u>      |
| Total  | <u>\$ 383,817</u> | <u>\$ 307,195</u> |

## 9. DESIGNATIONS OF UNRESTRICTED NET ASSETS

Unrestricted net assets are designated for specific purposes by action of the Board of Trustees or management or may otherwise be limited by contractual agreements. Commitments for the use of unrestricted net assets as of June 30, 2007 and 2006, respectively, are as follows (in thousands):

|  | <u>2007</u>      | <u>2006</u>      |
|--|------------------|------------------|
| Working capital requirements                             | \$287,077        | \$246,063        |
| Budget appropriations for future year fiscal operations  | 66,928           | 32,462           |
| Designated for capital projects                          | 34,640           | 53,958           |
| Designated for renewal and replacement of capital assets | 27,508           | 73,396           |
| Hospital   | 185,372          | 137,608          |
| Affiliated corporations                                  | <u>64,031</u>    | <u>64,190</u>    |
| Total  | <u>\$665,556</u> | <u>\$607,677</u> |

## 10. PLEDGED REVENUES

Under the University's General Receipts Trust Indenture, substantially all of the unrestricted operating and non-operating revenues of the University are pledged to secure the payment of debt. For the years ended June 30, 2007 and 2006, respectively, pledged revenues are as follows (in thousands):

|   | <u>2007</u>         | <u>2006</u>         |
|---|---------------------|---------------------|
| Student tuition and fees                          | \$ 166,742          | \$ 147,267          |
| Nongovernmental grants and contracts              | 6,916               | 7,543               |
| Recoveries of facilities and administrative costs | 43,792              | 43,303              |
| Sales and services                                | 45,717              | 42,024              |
| Hospital services                                 | 579,222             | 520,310             |
| Auxiliary enterprises - housing and dining        | 35,783              | 36,385              |
| Auxiliary enterprises - other                     | 21,705              | 20,633              |
| Other operating revenue                           | 1,507               | 2,222               |
| State appropriations                              | 319,859             | 314,294             |
| Gifts and grants                                  | 2,087               | 1,123               |
| Investment income                                 | 30,654              | 55,382              |
|   | <u>\$ 1,253,984</u> | <u>\$ 1,190,486</u> |

## 11. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2007 and 2006 are as follows (in thousands):

|   | <u>2007</u>       | <u>2006</u>       |
|---|-------------------|-------------------|
| Interest and dividends earned on endowment investments                | \$ 20,860         | \$ 13,706         |
| Realized and unrealized gains and losses on endowment investments     | 104,660           | 39,368            |
| Interest and dividends on cash and non-endowment investments          | 30,035            | 24,979            |
| Realized and unrealized gains and losses on non-endowment investments | 3,689             | 40,022            |
| Investment income from external trusts                                | 1,731             | 992               |
| Total   | <u>\$ 160,975</u> | <u>\$ 119,067</u> |

## 12. FUNDS HELD IN TRUST BY OTHERS

The University is the income beneficiary of various trusts that are held and controlled by external trustees. For the years ended June 30, 2007 and 2006, the University received income from these trusts of approximately \$1,731,000 and \$992,000, respectively. The market value of the external trust assets as of June 30, 2007 and 2006 was approximately \$45,028,000 and \$40,706,000, respectively. As the University does not have ownership of the trust assets held by external trustees, the trusts are recorded at a nominal value of \$1 each.

### 13. PLEDGES AND DEFERRED GIFTS

At June 30, 2007, pledges totaling approximately \$65,678,000 are expected to be collected primarily over the next five years, as follows (in thousands):

|                     |                  |
|---------------------|------------------|
| Operating purposes  | \$ 10,384        |
| Capital projects    | 24,789           |
| Endowment principal | <u>30,505</u>    |
| Total               | <u>\$ 65,678</u> |

In accordance with GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions," the University is required to record operating and capital pledges as revenue when all eligibility requirements have been met. Endowment pledges are not recognized as revenue until the gifts are actually received. Accordingly, for the years ended June 30, 2007 and 2006, the University recorded the discounted value of operating and capital pledges, net of the allowance for uncollectible pledges, of approximately \$19,966,000 and \$15,279,000, respectively.

Deferred gifts through insurance, known bequests and irrevocable trusts in which the University has a remainder interest are estimated to be approximately \$100,509,000 at June 30, 2007. The University records these amounts as revenue when the cash is received.

### 14. GRANTS AND CONTRACTS AWARDED

At June 30, 2007, grants and contracts of approximately \$390 million have been awarded to the University and the University of Kentucky Research Foundation but not expended. These amounts will be recognized in future periods.

### 15. PENSION PLANS

Regular full-time employees, including faculty, are participants in the University of Kentucky Retirement Plan, a defined contribution plan. The University of Kentucky Retirement Plan consists of five groups as follows:

|           |  |
|-----------|--|
| Group I   | Established July 1, 1964, for faculty and certain administrative officials.  |
| Group II  | Established July 1, 1971, for staff members in the clerical, technical and service categories.   |
| Group III | Established July 1, 1972, for staff members in the managerial, professional and scientific categories.   |
| Group IV  | Established January 1, 1973, for staff members having U.S. Civil Service retirement entitlement.   |
| Group V   | Established July 1, 1987, for staff members covered under the Federal Employees Retirement System that replaced Civil Service (those whose employment began during the period from January 1, 1984 to March 31, 1987). Staff members whose employment began after March 31, 1987 are under one of the above University of Kentucky Retirement Plans. |

Participation in the University of Kentucky Retirement Plan is mandatory for all regular full-time employees in groups I, II and III who are age 30 or older. Participation is voluntary for regular full-time employees under the age of 30 and for those employees in groups IV and V. Participants in groups I, II, III and IV contribute 5 percent and the University contributes 10 percent of the participant's eligible compensation to the retirement plan. Participants in group V contribute 1 percent and the University contributes 2 percent of the participant's eligible compensation to the retirement plan.

The University has authorized three retirement plan carriers, as follows:

Teachers Insurance and Annuity Association/College  
Retirement Equities Fund (TIAA/CREF)  
Fidelity Investments Institutional Services Company  
American Century Investments

Under the fully funded University of Kentucky Retirement Plan, the University and plan participants make contributions to provide fully vested retirement benefits to employees in individually owned contracts. The University's contributions and costs for 2007 and 2006 were approximately \$62,534,000 and \$58,578,000, respectively. Employees contributed approximately \$31,003,000 in 2007 and \$29,120,000 in 2006. The University's total payroll costs were approximately \$848,973,000 and \$804,628,000, respectively, for the years ended June 30, 2007 and 2006. The payroll for employees covered by the retirement plan was approximately \$625,344,000 and \$585,778,000 for the years ended 2007 and 2006, respectively.

In addition to retirement benefits provided from the group retirement plan, the University provides supplemental retirement income benefits to certain eligible employees in each of the retirement groups (see Note 16).

#### **16. MINIMUM ANNUAL RETIREMENT BENEFITS AND SUPPLEMENTAL RETIREMENT INCOME**

Employees in retirement groups I, II and III, referred to in Note 15 above, who were age 40 or older prior to the date of establishment of each group plan, and who were employed by the University prior to that date, qualify for the minimum annual retirement benefit provisions of the retirement plan. Benefits for these eligible employees are based upon a percentage, determined through years of service, of the participant's annual salary in the last year of employment prior to retirement. Retirement benefits as determined are funded by each individual retiree's accumulation in the group retirement plan, with the balance, if necessary, provided by the University as supplemental retirement income.

The Legislature of the Commonwealth of Kentucky has appropriated funds to the University for the payment of supplemental retirement income benefits since adoption of the group retirement plans, and is expected to continue this practice. However, the Constitution of the Commonwealth of Kentucky prohibits the commitment of future revenues beyond the end of the current biennium. Accordingly, the University does not recognize the liability for supplemental retirement income benefits during the service life of covered employees, but recognizes its costs when funds are appropriated by the Legislature and payments are made. The University intends to continue paying supplemental retirement income benefits contingent upon the Legislature continuing to appropriate funds required to make these payments. Supplemental retirement benefit payments were approximately \$3,089,000 and \$3,255,000 for the years ended June 30, 2007 and 2006, respectively.

The latest actuarial valuation was prepared as of July 1, 2006, by TIAA. The actuarial present value of accumulated supplemental retirement income benefits as determined by this valuation, utilizing an assumed rate of return of 7 percent, was \$18,356,000.

#### **17. HEALTH INSURANCE BENEFITS FOR RETIREES**

The University provides a health care credit towards health insurance coverage to retirees who have a minimum of fifteen years service. The University recognizes the cost of providing this credit by expensing the credit in the year provided. These health care credits totaled approximately \$6,203,000 and \$7,716,000 for the years ended June 30, 2007 and 2006, respectively. As of June 30, 2007, there were approximately 2,200 retirees who met the service requirement and were receiving the health care credit.

#### **18. RISK MANAGEMENT**

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims, or (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance, participation in insurance risk retention groups or self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and most other causes of loss between \$250,000 and \$500,000 per occurrence. Losses in excess of \$500,000 are insured by commercial carriers up to \$500 million per occurrence, buildings at replacement cost and contents on an actual cash value basis. As a state agency, the University is vested with Sovereign Immunity and is subject to the provisions of the Board of Claims Act, under which the University's liability for certain negligence claims is limited to \$200,000 for any one person or \$350,000 for all persons damaged by a single act of negligence. Claims against educators' errors and omissions and wrongful acts are insured through a reciprocal risk retention group. There have been no significant reductions in insurance coverage from 2006 to 2007. Settlements have not exceeded insurance coverage during the past three years.

The University and its agents are insured against medical malpractice by a combination of Sovereign Immunity, self-insurance, commercial liability insurance, and an excess coverage fund established by the Commonwealth of Kentucky. The malpractice liability as of June 30, 2007 is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be recorded if it is probable that a liability has occurred and the amount of loss can be reasonably estimated. The liability includes an estimate for claims that have been incurred but not reported as of June 30, 2007.

The University is self-insured for the long-term disability income program and has established a 501(c)(9) trust for purposes of paying claims and establishing necessary reserves. The estimated long-term disability payments for known claims as of June 30, 2007 are reported at their present value assuming an investment yield of 6 percent.

The University also self-insures certain employee benefits, including health insurance, worker's compensation, unemployment claims, and a long-term disability supplemental reserve, to the extent not covered by insurance. The University has recorded an estimate for asserted claims at June 30, 2007.

Long-term liabilities related to self-insurance are detailed in Note 7, above.

## **19. CONTINGENCIES**

The University is a defendant in various lawsuits. The nature of the educational and health care industries is such that, from time to time, claims will be presented on account of alleged negligence, acts of discrimination, medical malpractice, breach of contract or disagreements arising from the interpretation of laws or regulations. While some of these claims may be for substantial amounts, they are not unusual in the ordinary course of providing educational and health care services at a large institution. However, University officials are of the opinion, based on advice of in-house legal counsel, that the effect of the ultimate outcome of all litigation will not be material to the future operations or financial position of the University.

## **20. RESEARCH CHALLENGE TRUST FUND**

The Research Challenge Trust Fund (RCTF) was created by the Kentucky General Assembly with the passage of the Postsecondary Education Improvement Act of 1997 (House Bill 1). The objectives of the Trust Fund, as stated in the Bill, include support of efforts by the University of Kentucky to attain status as a top-20 public research university. The RCTF Endowment Match Program provides state funds on a dollar-for-dollar match basis. This program, also known as "Bucks for Brains", supports endowed chairs, professorships and graduate fellowships, and the research and graduate mission of the University.

The status of the RCTF endowed funds as of June 30, 2007, is summarized as follows (in thousands):

|               | <u>Kentucky<br/>General<br/>Assembly<br/>Funding</u> | <u>University<br/>of Kentucky<br/>Share of<br/>Funding</u> | <u>State Funds<br/>Received<br/>to Date</u> | <u>Matching<br/>Pledges<br/>Receivable</u> |
|---------------|--|--|---|--|
| 1998 Biennium | \$ 100,000   | \$ 66,667  | \$ 66,667                                   |  |
| 2000 Biennium | 100,000  | 68,857   | 68,857                                      | \$ 191                                     |
| 2002 Biennium | <u>100,000</u>                                       | <u>66,667</u>  | <u>40,811</u>                               | <u>12,084</u>                              |
| Total         | <u>\$ 300,000</u>                                    | <u>\$ 202,191</u>  | <u>\$ 176,335</u>                           | <u>\$ 12,275</u>                           |

Interest income of approximately \$2.2 million earned on the state matching funds is included in the University's share of the 2000 Biennium funding. Requests to the State for RCTF funds totaling approximately \$23.1 million have been submitted and are outstanding as of June 30, 2007.

The University expects to fully realize all outstanding matching pledges; however, it may be obligated to return any state funds and accrued interest income related to pledges not received within five years of the initial pledge dates if unable to replace the unpaid pledges with other eligible gifts. A payment schedule of the outstanding pledges is shown below (in thousands):

|   | <u>2000<br/>Biennium</u> | <u>2002<br/>Biennium</u> |
|---|--------------------------|--------------------------|
| Pledges due in fiscal years 2007 or prior | \$ 109                   | \$ 635                   |
| Pledges due in fiscal year 2008           | 82                       | 1,547                    |
| Pledges due in fiscal year 2009           | -                        | 1,603                    |
| Pledges due in fiscal year 2010           | -                        | 1,253                    |
| Pledges due in fiscal year 2011           | -                        | 7,012                    |
| Pledges due in fiscal year 2012           | <u>-</u>                 | <u>34</u>                |
| Total                                     | <u>\$ 191</u>            | <u>\$ 12,084</u>         |

Pledges due in fiscal years 2007 or prior reflected above includes unpaid pledges of approximately \$35,000 that are past five years of the initial pledge date. The University intends to replace the unpaid pledges with other eligible gifts.

## 21. CANCER RESEARCH MATCHING FUND

The Kentucky General Assembly created the Cancer Research Institutions Matching Fund, which is funded by a one-cent surtax levied on each 20 cigarettes sold in Kentucky. Tax revenues are made available equally to the University of Kentucky and the University of Louisville when matched dollar-for-dollar by private sources.

A summary of the receipts and expenses related to the fund as of June 30, 2007 and 2006, respectively, is as follows (in thousands):

|   | <u>2007</u>     | <u>2006</u>     |
|---|-----------------|-----------------|
| Funds from private sources approved for match | \$ 2,346        | \$ 4,227        |
| Cigarette excise tax funds distributed        | <u>3,119</u>    | <u>3,054</u>    |
| Total cancer research matching fund revenues  | <u>\$ 5,465</u> | <u>\$ 7,281</u> |
| Cancer research matching fund expenses        | <u>\$ 3,996</u> | <u>\$ 2,720</u> |



## 22. NATURAL CLASSIFICATION

The University's operating expenses by natural classification were as follows for the years ended June 30, 2007 and 2006, respectively (in thousands):

|  | <u>2007</u>         | <u>2006</u>         |
|--|---------------------|---------------------|
| Salaries and wages                     | \$ 852,929          | \$ 789,040          |
| Employee benefits                      | 248,154             | 224,907             |
| Supplies and services                  | 422,517             | 360,947             |
| Depreciation                           | 90,270              | 83,761              |
| Student scholarships and financial aid | 36,559              | 36,065              |
| Purchased utilities                    | 38,560              | 36,648              |
| Hospital bad debt expense              | 45,060              | 51,769              |
| Other, various                         | 74,579              | 56,430              |
| Total                                  | <u>\$ 1,808,628</u> | <u>\$ 1,639,567</u> |

## 23. RECLASSIFICATIONS

Certain reclassifications to fiscal 2006 comparative amounts have been made to conform to the 2007 classifications. Certain transactions previously reported on a net basis in the Consolidated Statement of Revenues, Expenses, and Changes in Net Assets are now being reported on a gross basis. Additionally, certain investments previously reported as current are now recorded as long-term based on revised utilization expectations.

## 24. SUBSEQUENT EVENTS

On July 1, 2007, the University purchased Good Samaritan Hospital, a 336 bed community hospital located in Lexington, Kentucky, contiguous to the University campus. The purchase price, exclusive of direct transaction costs, was approximately \$13,000,000.

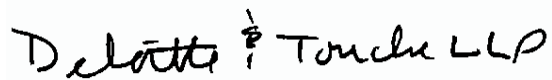
## INDEPENDENT AUDITORS' REPORT ON ADDITIONAL INFORMATION

To the Board of Trustees of the  
University of Kentucky

and

the Secretary of Finance and  
Administration Cabinet of the  
Commonwealth of Kentucky

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The additional consolidating information contained on pages 39 and 40 is presented for the purpose of additional analysis and is not a required part of the basic consolidated financial statements. This additional information is the responsibility of the University's management. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic consolidated financial statements taken as a whole.

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, slightly stylized font.

October 5, 2007

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

CONSOLIDATING SCHEDULE

STATEMENT OF NET ASSETS

JUNE 30, 2007

(in thousands)



|  | UK           | Research Foundation | The Fund  | Gluck Equine Research Foundation | Athletic Association | Humanities Foundation | Mining Engineering Foundation | Business Partnership Foundation | Center on Aging | Central Kentucky Management Services | Kentucky Medical Services Foundation | Total        |
|--|--------------|---------------------|-----------|----------------------------------|----------------------|-----------------------|-------------------------------|---------------------------------|-----------------|--------------------------------------|--------------------------------------|--------------|
| <b>ASSETS</b>  |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| <b>Current Assets</b>                                  |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Cash and cash equivalents                              | \$ 340,069   | \$ 10               | \$ 11,533 | \$ 2,950                         | \$ 13,725            | \$ 52                 | \$ 3                          | \$ 365                          | \$ 40           | \$ 617                               | \$ 2,924                             | \$ 372,288   |
| Notes, loans and accounts receivable, net              | 108,197      | 56,975              | 2,844     |                                  | 522                  |                       |                               | 1                               |                 |                                      | 36,810                               | 205,349      |
| Investments  |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      | 4,197                                | 4,197        |
| Inventories and other                                  | 21,565       | 2,201               |           |                                  | 3,075                |                       |                               |                                 |                 | 12                                   | 33                                   | 26,886       |
| Total current assets                                   | 469,831      | 59,186              | 14,377    | 2,950                            | 17,322               | 52                    | 3                             | 366                             | 40              | 629                                  | 43,964                               | 608,720      |
| <b>Noncurrent Assets</b>                               |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Restricted cash and cash equivalents                   | 143,080      |                     |           |                                  |                      |                       | 36                            |                                 |                 |                                      |                                      | 143,116      |
| Endowment investments                                  | 910,764      | 4,748               | 252       | 9,937                            | 350                  | 1,516                 | 2,118                         | 15,621                          |                 |                                      | 44,000                               | 945,306      |
| Other long-term investments                            | 123,672      | 1,585               |           |                                  | 3,176                |                       |                               |                                 |                 |                                      |                                      | 172,433      |
| Notes, loans and accounts receivable, net              | 37,917       |                     |           |                                  |                      | 3                     |                               | 6                               |                 |                                      | 256                                  | 38,182       |
| Other noncurrent assets                                | 20,552       | 6                   |           |                                  |                      |                       |                               |                                 |                 |                                      | 596                                  | 21,154       |
| Capital assets, net                                    | 1,131,836    | 9,892               |           |                                  | 48,027               |                       |                               |                                 |                 | 475                                  | 18,440                               | 1,208,670    |
| Total noncurrent assets                                | 2,367,821    | 16,231              | 252       | 9,937                            | 51,553               | 1,519                 | 2,154                         | 15,627                          | -               | 475                                  | 63,292                               | 2,528,861    |
| Total assets   | 2,837,652    | 75,417              | 14,629    | 12,887                           | 68,875               | 1,571                 | 2,157                         | 15,993                          | 40              | 1,104                                | 107,256                              | 3,137,581    |
| <b>LIABILITIES</b>                                     |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| <b>Current Liabilities</b>                             |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Accounts payable and accrued liabilities               | 142,352      | 9,461               | 382       |                                  | 1,997                |                       | 1                             | 1                               |                 | 629                                  | 6,811                                | 161,634      |
| Deferred revenue                                       | 17,066       | 31,276              |           |                                  | 11,943               |                       |                               |                                 |                 |                                      |                                      | 60,285       |
| Long-term liabilities - current portion                | 54,536       | 631                 |           |                                  | 1,265                |                       |                               |                                 |                 |                                      | 21,644                               | 78,076       |
| Total current liabilities                              | 213,954      | 41,368              | 382       | -                                | 15,205               | -                     | 1                             | 1                               | -               | 629                                  | 28,455                               | 299,995      |
| <b>Noncurrent Liabilities</b>                          |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Long-term liabilities                                  | 514,666      | 4,869               |           |                                  | 37,770               |                       |                               |                                 |                 |                                      | 2,630                                | 559,935      |
| Total liabilities                                      | 728,620      | 46,237              | 382       | -                                | 52,975               | -                     | 1                             | 1                               | -               | 629                                  | 31,085                               | 859,930      |
| <b>INTERFUND BALANCES</b>                              | 34,324       | (11,842)            | (773)     |                                  | (151)                |                       |                               |                                 |                 |                                      | (21,558)                             | -            |
| <b>NET ASSETS</b>                                      |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| <b>Invested in capital assets, net of related debt</b> | 743,643      | 4,391               |           |                                  | 12,167               |                       |                               |                                 |                 | 475                                  | 13,286                               | 773,962      |
| <b>Restricted</b>                                      |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Nonexpendable  | 439,754      | 889                 | 31        | 4,676                            |                      | 640                   | 642                           | 7,684                           |                 |                                      |                                      | 454,316      |
| Expendable   | 358,435      | 4,184               | 1,787     | 8,211                            | 407                  | 931                   | 1,514                         | 8,308                           | 40              |                                      |                                      | 383,817      |
| Total restricted                                       | 798,189      | 5,073               | 1,818     | 12,887                           | 407                  | 1,571                 | 2,156                         | 15,992                          | 40              | -                                    | -                                    | 838,133      |
| <b>Unrestricted</b>                                    | 601,524      | 7,874               | 11,656    |                                  | 3,175                |                       |                               |                                 |                 |                                      | 41,327                               | 665,556      |
| Total net assets                                       | \$ 2,143,356 | \$ 17,338           | \$ 13,474 | \$ 12,887                        | \$ 15,749            | \$ 1,571              | \$ 2,156                      | \$ 15,992                       | \$ 40           | \$ 475                               | \$ 54,613                            | \$ 2,277,651 |

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS  
CONSOLIDATING SCHEDULE FOR THE YEAR ENDED JUNE 30, 2007  
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS  
(in thousands)

|   | UK           | Research Foundation | The Fund  | Gluck Equine Research Foundation | Athletic Association | Humanities Foundation | Mining Engineering Foundation | Business Partnership Foundation | Center on Aging | Central Kentucky Management Services | Kentucky Medical Services Foundation | Total        |
|---|--------------|---------------------|-----------|----------------------------------|----------------------|-----------------------|-------------------------------|---------------------------------|-----------------|--------------------------------------|--------------------------------------|--------------|
| <b>OPERATING REVENUES</b>   | \$ 166,742   |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | \$ 166,742   |
| Student tuition and fees, net                                       | 10,986       | \$ 159,480          |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 170,466      |
| Federal grants and contracts  | 34,424       | 61,467              | \$ 10     |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 95,901       |
| State and local grants and contracts                                | 4,625        | 24,955              | 2,289     |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 31,869       |
| Nongovernmental grants and contracts                                | 223          | 43,969              |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 43,792       |
| Recoveries of facilities and administrative costs                   | 26,407       | 1,956               | 11,840    |                                  |                      |                       |                               | \$ 7                            | \$ 5,507        |                                      |                                      | 45,717       |
| Sales and services  | 17,858       |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 17,858       |
| Federal appropriations  | 12,818       |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 12,818       |
| County appropriations   |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Professional clinical service fees                                  | 579,222      |                     |           |                                  |                      |                       |                               |                                 |                 |                                      | \$ 164,432                           | 164,432      |
| Hospital patient services   |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Auxiliary enterprises:  |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Housing and Dining, net   | 35,783       |                     |           |                                  | \$ 47,517            |                       |                               |                                 |                 |                                      |                                      | 35,783       |
| Athletics   | 21,705       |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 21,705       |
| Other auxiliaries   | 446          |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 446          |
| Other operating revenues  | 911,239      | 291,427             | 14,246    | 107                              | 47,517               |                       |                               |                                 | 7               | 5,507                                | 954                                  | 1,435,329    |
| Total operating revenues  |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| <b>OPERATING EXPENSES</b>   |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Educational and general:  |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Instruction   | 242,129      | 15,184              | 485       |                                  | \$                   | 5                     | \$                            | 34                              | \$              | 118                                  |                                      | 257,955      |
| Research  | 75,780       | 166,327             | 143       | \$ 1                             |                      |                       |                               | 34                              | 189             |                                      |                                      | 242,474      |
| Public service  | 106,547      | 87,879              | 913       |                                  |                      |                       | 8                             |                                 |                 |                                      |                                      | 195,347      |
| Libraries   | 16,589       |                     | 3         |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 16,592       |
| Academic support  | 61,618       | 2,511               | 2,909     |                                  |                      | 4                     |                               | 437                             |                 |                                      |                                      | 67,475       |
| Student services  | 22,726       | 31                  | 75        |                                  |                      |                       |                               |                                 | 5,161           |                                      |                                      | 22,836       |
| Institutional support   | 52,537       | 844                 | 314       | 9                                |                      |                       |                               |                                 |                 |                                      |                                      | 58,865       |
| Operations and maintenance of plant                                 | 55,554       |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 55,554       |
| Student financial aid   | 21,074       | 1,879               | 106       |                                  |                      | 44                    |                               | 113                             |                 |                                      |                                      | 23,216       |
| Depreciation  | 60,887       | 379                 |           |                                  |                      |                       |                               |                                 |                 | 58                                   |                                      | 61,324       |
| Total educational and general                                       | 715,441      | 275,034             | 4,948     | 10                               |                      | 53                    | 76                            | 668                             | 189             | 5,219                                |                                      | 1,001,638    |
| Clinical operations (including depreciation of \$1,342)             |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Hospital (including depreciation of \$21,692)                       | 566,048      |                     | 558       |                                  |                      |                       |                               |                                 |                 |                                      | 134,614                              | 566,606      |
| Auxiliary enterprises:  |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| Housing and Dining (including depreciation of \$3,433)              | 38,133       |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 38,133       |
| Athletics (including depreciation of \$2,479)                       | 201          |                     |           |                                  | 53,591               |                       |                               |                                 |                 |                                      |                                      | 53,792       |
| Other auxiliaries   | 13,617       |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 13,617       |
| Other expenses  | 228          |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 228          |
| Total operating expenses  | 1,333,668    | 275,034             | 5,506     | 10                               | 53,591               | 53                    | 76                            | 668                             | 189             | 5,219                                | 134,614                              | 1,808,628    |
| Net income (loss) from operations                                   | (422,429)    | 16,393              | 8,740     | (10)                             | (6,074)              | (53)                  | (76)                          | (668)                           | (182)           | 288                                  | 30,772                               | (373,299)    |
| <b>NONOPERATING REVENUES (EXPENSES)</b>                             |              |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      |              |
| State appropriations  | 319,859      |                     |           |                                  |                      |                       |                               |                                 |                 |                                      |                                      | 319,859      |
| Gifts and grants  | 32,843       |                     | 1,008     | 130                              |                      | 54                    |                               | 74                              | 109             |                                      |                                      | 34,218       |
| Investment income   | 153,354      | 689                 | 611       | 1,572                            | 565                  | 216                   | 312                           | 2,246                           | 5               | 36                                   |                                      | 160,975      |
| Interest on capital asset-related debt                              | (10,734)     | (37)                |           |                                  | (1,952)              |                       |                               |                                 |                 |                                      |                                      | (12,723)     |
| Grant to/from the University for non-capital purposes               | 53,033       | (17,099)            | (8,364)   | (508)                            | 9,442                | (7)                   | (10)                          | (119)                           |                 |                                      |                                      |              |
| Other nonoperating revenues and expenses, net                       | (12)         | 1,646               |           |                                  | 1,488                |                       |                               |                                 |                 |                                      |                                      | 3,122        |
| Net nonoperating revenues (expenses)                                | 548,343      | (14,801)            | (6,745)   | 1,194                            | 9,543                | 263                   | 302                           | 2,201                           | 114             | 36                                   | (34,999)                             | 505,451      |
| Net income (loss) before other revenues, expenses, gains, or losses | 125,914      | 1,592               | 1,995     | 1,184                            | 3,469                | 210                   | 226                           | 1,533                           | (66)            | 324                                  | (4,227)                              | 132,152      |
| Capital grants and gifts  | 12,279       | 11,407              |           |                                  |                      |                       |                               |                                 |                 |                                      | (150)                                | 23,536       |
| Additions to permanent endowments                                   | 29,829       | 1                   |           |                                  |                      |                       |                               | 101                             |                 |                                      |                                      | 29,931       |
| Grant to/from the University for capital purposes                   | 15,375       | (11,500)            | (347)     |                                  | (3,491)              |                       |                               | (18)                            | (19)            | (50)                                 | 1,861                                | (10,070)     |
| Other, net  | (12,347)     | 501                 |           |                                  | (35)                 |                       |                               |                                 |                 | (50)                                 |                                      | 43,397       |
| Total other revenues  | 45,136       | 409                 | (347)     |                                  | (3,526)              |                       |                               | 83                              | (19)            | (50)                                 | 1,711                                | (2,516)      |
| Increase (decrease) in net assets                                   | 171,050      | 2,001               | 1,648     | 1,184                            | (57)                 | 210                   | 226                           | 1,616                           | (87)            | 274                                  | (2,516)                              | 175,549      |
| NET ASSETS, beginning of year                                       | 1,972,306    | 15,337              | 11,826    | 11,703                           | 15,806               | 1,361                 | 1,930                         | 14,376                          | 127             | 201                                  | 57,129                               | 2,102,102    |
| NET ASSETS, end of year   | \$ 2,143,356 | \$ 17,338           | \$ 13,474 | \$ 12,887                        | \$ 15,749            | \$ 1,571              | \$ 2,156                      | \$ 15,992                       | \$ 40           | \$ 475                               | \$ 54,613                            | \$ 2,277,651 |

**University of Kentucky**  
**Governing Board and Administrative Staff as of June 30, 2007**

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Pamela R. May, Secretary

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