

# UK<sup>®</sup>

UNIVERSITY OF  
KENTUCKY<sup>®</sup>



# 2011

## Financial Statements



University of Kentucky  
A Component Unit of the Commonwealth of Kentucky  
Financial Statements  
Years Ended June 30, 2011 and 2010

TABLE OF CONTENTS

Message from the President	i
Independent Accountants' Report on Financial Statements and Supplementary Information	1
Management's Discussion and Analysis	3
Financial Statements	
Statements of Net Assets	15
Statements of Revenues, Expenses and Changes in Net Assets	16
Statements of Cash Flows	17
Notes to Financial Statements	18
Supplementary Information	
Required Supplementary Information	46
Statement of Net Assets Schedule	48
Statement of Revenues, Expenses and Changes in Net Assets Schedule	49
Governing Board and Administrative Staff	

## MESSAGE FROM THE PRESIDENT



The 2008 recession laid siege to the global market and forced the hand of the U.S. government and private industry to address the foundation and fundamental characteristics of our economy. Although policymakers have made education a priority in the recovery period, the fallout from the recession and sluggish market growth has stressed state budgets and limited public support.

The result is that we – along with other national research universities – are competing for a scarce resource base to continue the important work and service we provide as the state’s flagship institution.

The tumultuous budget cycles continue to yield fewer state dollars for the University of Kentucky. The decrease in state support has been cushioned by strong investment

performance. Following the 2008 recession, our endowment pool market value dropped from a \$938.4 million high in June 2007 to a \$788.0 million as of June 30, 2010. I am proud to report that, as of June 30, 2011, the endowment pool market value has exceeded the 2007 levels with current market value at \$945.5 million. Including other investment classes, the University of Kentucky’s portfolio is valued over \$1.1 billion for the first time since 2007.

Research awards received during fiscal year 2010-11 total \$299.1 million, an 11 percent decrease over the prior year; primarily the result of the loss of new American Recovery and Reinvestment Act (ARRA) awards. Over the life of the Recovery Act program, the University was a major competitor, receiving \$111.5 million in total ARRA awards. Over half of our total research grants and contracts in fiscal year 2010-11 were awarded by the federal government, primarily the National Institutes of Health, other Public Health Service agencies and the National Science Foundation.

Tuition rate increases of recent years have been moderate, reflecting sensitivity to the economic condition of families across our state. As a result, tuition revenue has not been sufficient to offset declines in state support and increases in fixed costs. The result has been substantial reallocation of funds during the last three budget cycles; while these choices have been difficult, our institution is more focused and efficient in the execution of our mission. We, in the face of great obstacles, have maintained a steadfast commitment to educating and preparing our students for the 21<sup>st</sup> century economy and continued our outreach and service oriented mission as the Commonwealth of Kentucky’s flagship land-grant research institution. We have demonstrated excellent stewardship of state appropriations, tuition dollars, support from our alumni and friends and our awarded grant and contract revenue. Net assets have increased \$242.2 million to \$2.63 billion during the last fiscal year. We have experienced a



number of benchmark occasions over the last year, including:

- A total student enrollment of 28,037 in Fall 2010, besting our previous record high set in Fall 2006; and research and professional doctoral enrollment reached a new high of 4,225.
- The mean ACT Composite for the Fall 2010 first-year class increased to 25.2.
- UK enrolled a record 418 first-year African-American students in Fall 2010.
- UK achieved a first-to-second year retention rate greater than 80 percent for the third year in a row and, at 81.8 percent, it is the highest rate in the last 10 years.
- Final implementation of the new general education reform program, UK Core, was completed and is prepared for a full program launch in the Fall 2011 semester.
- In 2010-11, UK awarded 5,802 degrees, including 783 research and professional doctorates.
- UK completed a strong year in development, securing \$97.5 million in gifts and pledges from nearly 48,000 donors – a 19 percent increase in total gifts and a 14 percent increase in our donor base.
- The University was awarded a \$20 million Clinical Translational Sciences Award from the National Institutes of Health – an award that recognizes UK as a national leader in moving science from the lab and into communities to address some of our most profound health challenges.

We have achieved a great deal in the face of a challenging economy. We have not been hindered by external circumstances, and our best days are still ahead.

Going forward, we must remember that, while we cannot direct the wind, we can adjust the sails. Our dreams have not changed, nor have the aspirations of the Commonwealth of Kentucky, but we must adjust our course and be more nimble in our execution.

The University's faculty and staff, our alumni and friends across Kentucky and beyond and the community and business leaders in our state have made two things clear. First, they are proud of the work the University of Kentucky does for our students and for the people of Kentucky. Second, their resolve for our mission is strong.

We remain committed to our dream, not for accolades or recognition, but because of the lives we touch, the improved general welfare of our society and betterment of our way of life.

Sincerely,



Eli Capilouto  
President

## Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees  
University of Kentucky  
Lexington, Kentucky

We have audited the accompanying basic financial statements of the University of Kentucky (University), a component unit of the Commonwealth of Kentucky, as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Kentucky Medical Services Foundation, Inc. (KMSF), which statements reflect total assets of \$110,370,427 and \$106,968,091 as of June 30, 2011 and 2010, respectively, and total revenues of \$210,443,090 and \$203,404,190, respectively, for the years then ended. Those financial statements were audited by other accountants whose report thereon has been furnished to us and our opinion, insofar as it relates to the amounts included for KMSF, is based solely on the report of the other accountants.

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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of KMSF, which are included in the University's reporting entity, were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other accountants provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other accountants, the financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2011, on our consideration of the University's 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 audits.

The accompanying management's discussion and analysis and post-employment benefit information, as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the supplementary information and express no opinion on it.

Our 2011 audit was conducted for the purpose of forming an opinion on the 2011 basic financial statements. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the 2011 basic financial statements. Such supplementary information has been subjected to the auditing procedures applied in the audit of the 2011 basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the 2011 basic financial statements taken as a whole.

*BKD, LLP*

September 29, 2011

# Management's Discussion and Analysis

The following Management's Discussion and Analysis (MD&A) provides an overview of the financial position and activities of the University of Kentucky (the University or UK) and its affiliated corporations for the years ended June 30, 2011 and June 30, 2010. Management has prepared this discussion, and suggests that it be read in conjunction with the financial statements and the notes appearing in this report.

## **About the University of Kentucky**

**Mission.** The University of Kentucky is a public, land-grant university dedicated to improving people's lives through excellence in education, research and creative work, service and health care. As Kentucky's flagship institution, the University plays a critical leadership role by promoting diversity, inclusion, economic development and human well-being.

**Vision.** The University of Kentucky will be one of the nation's 20 best public research universities.

**Values.** The University of Kentucky is guided by its core values:

- Integrity
- Excellence
- Mutual respect and human dignity
- Diversity and inclusion
- Academic freedom
- Shared governance
- Work-life sensitivity
- Civic engagement
- Social responsibility

**Background.** Under provisions of the federal Morrill Land-Grant Colleges Act (1862), Kentucky State Agricultural and Mechanical College was established in 1865 as part of Kentucky University (now Transylvania University). The College separated from Kentucky University in 1878 and was established on a 52 acre site (the University's current location) donated by the city of Lexington. In 1908 the College was re-named the State University, Lexington, Kentucky. In 1916 it became the University of Kentucky.

According to the Kentucky Revised Statutes (KRS) 164.125(2):

In carrying out its statewide mission, the University of Kentucky shall conduct statewide research and provide statewide services, including, but not limited to, agricultural research and extension services, industrial and scientific research, industrial technology extension services to Kentucky employers and research related to the doctoral, professional and postdoctoral programs offered within the University. The University may establish and operate centers and utilize state appropriations and other resources to carry out the necessary research and service activities throughout the state. The University may enter into joint research and service activities with other universities in order to accomplish its statewide mission.

In 1997, the Kentucky General Assembly reformed the state's public system of colleges and universities. According to the ***Kentucky Postsecondary Education Improvement Act*** of 1997:

The University of Kentucky is mandated to become a major comprehensive research institution ranked nationally in the top twenty public universities by 2020.

At its December 2005 meeting, the UK Board of Trustees approved the ***Top 20 Business Plan***. The ***Business Plan*** served as the framework for UK's funding and capital requests to the Kentucky General Assembly as it constructs the biennial Budget of the Commonwealth and focused on four primary areas of UK's mission-undergraduate education, graduate education, faculty activity and research.

The University's **Strategic Plan for 2009-2014** was adopted by the UK Board of Trustees at its June 2009 meeting. The **Strategic Plan** is designed to measure the University's progress by establishing specific goals for teaching, research and service at the department, college and university level. The Strategic Plan established five goals:

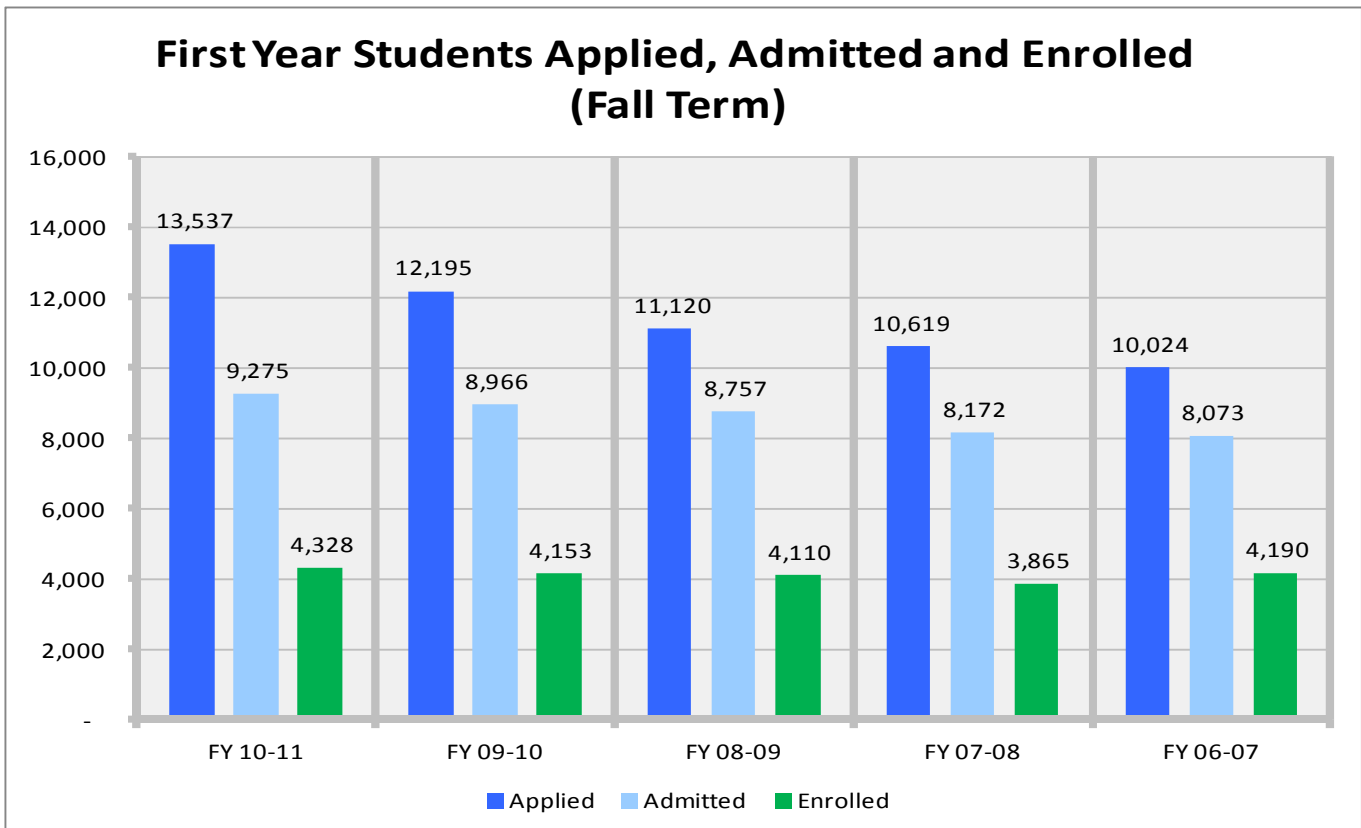
- Prepare Students for Leading Roles in an Innovation-driven Economy and Global Society
- Promote Research and Creative Work to Increase the Intellectual, Social, and Economic Capital of Kentucky and the World Beyond Its Borders
- Develop the Human and Physical Resources of the University to Achieve the Institution's Top 20 Goals
- Promote Diversity and Inclusion
- Improve the Quality of Life of Kentuckians through Engagement, Outreach and Service

Today, the University of Kentucky continues to focus on the core academic mission of the institution and the original tenets of the Morrill Land-Grant Colleges Act (1862). We remain steadfast in our commitment to produce graduates prepared for a 21<sup>st</sup> century economy, research important to the Commonwealth of Kentucky and service to our community and region.

The University of Kentucky is identified as a "Doctoral/Research University-Extensive" institution by the Carnegie Commission on Higher Education. There are 151 such institutions in the United States (out of approximately 3,600 colleges and universities).

The University is accredited by the Commission on Colleges (CoC) of the Southern Association of Colleges and Schools (SACS). This has been re-affirmed at approximately 10-year intervals since 1915, with the next accreditation review scheduled for 2012. In addition, several degree programs and individual units are accredited by agencies appropriate to specific professions or fields.

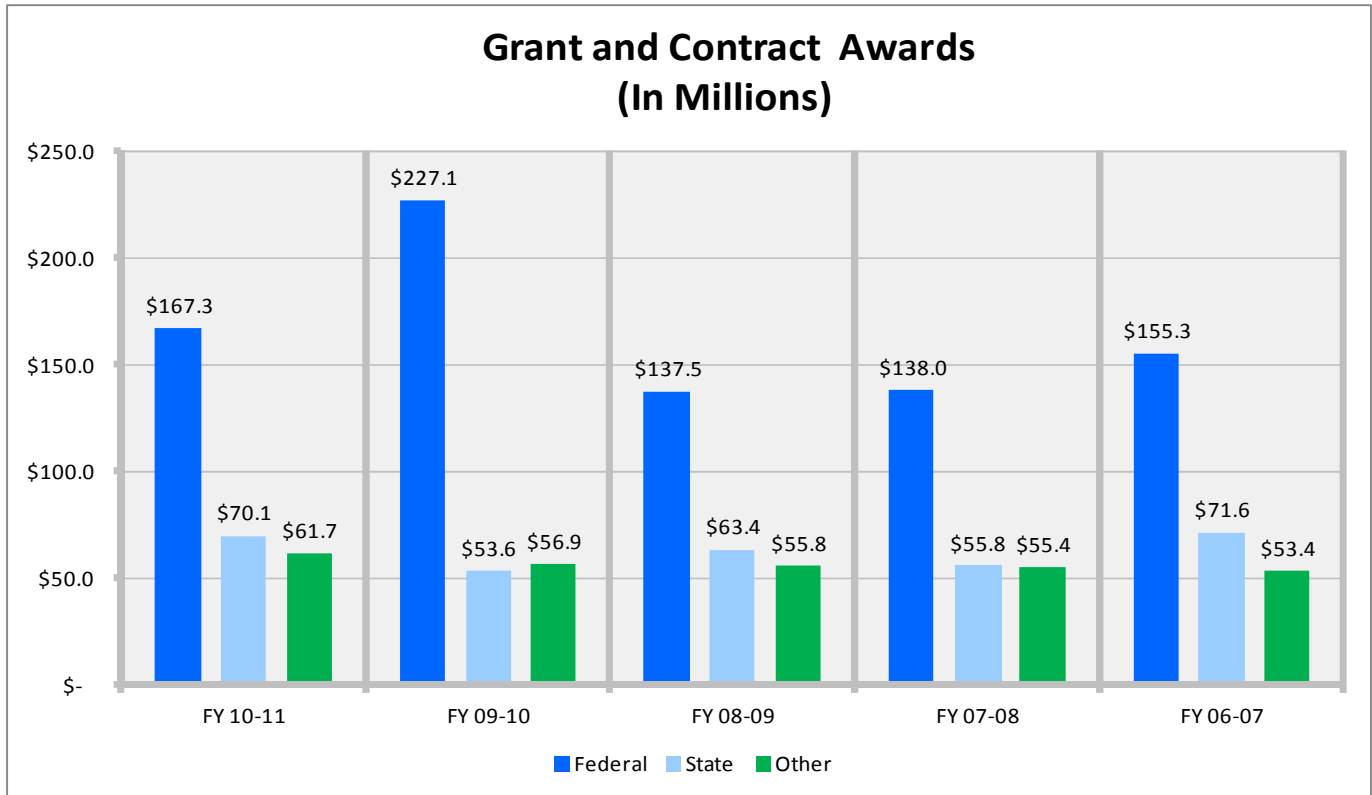
**Students.** In Fall 2010, the University of Kentucky had 28,037 undergraduate, graduate, and professional students. They represent all 120 Kentucky counties, every state in the U.S. and over 100 countries. Enrollment has increased over 3,200 students (13 percent) in 10 years.





**Programs.** The University offers over 200 majors and degree programs in 17 academic and professional colleges. UK is one of only seven public universities nationally to house colleges of Agriculture, Engineering, Medicine and Pharmacy on a single campus.

**Research.** Total research expenditures, as reported to the National Science Foundation (NSF), totaled \$360.0 million for fiscal year 2009-10, compared to \$352.0 million in 2008-09. Research awards received during fiscal year 2010-11 total \$299.1 million, an 11 percent decrease over the prior year; primarily the result of the loss of American Recovery and Reinvestment Act awards.



**Outreach.** As Kentucky’s flagship, land-grant university, UK engages citizens and communities across the state in a myriad of ways, including extension offices in all 120 Kentucky counties; continuing education opportunities for teachers, lawyers and health care providers; clinics providing legal, pharmaceutical and health care assistance; and a multitude of research efforts aimed at Kentucky’s most difficult problems in economic development, health care, infrastructure and education.

**Medical Centers.** UK HealthCare operates two hospitals – Chandler and Good Samaritan – and is considered one of the finest academic medical centers in the U.S. The hospitals have a combined 791 licensed beds and have an average daily occupancy of 529.87 beds. On a monthly basis, the hospitals provide over: 1,100 inpatient surgeries, 1,100 outpatient surgeries, 26,700 radiology procedures, 28,300 outpatient services, and 53,000 outpatient clinic visits at the hospitals and at clinics throughout the state.

In May 2011, the opening of the lobby, concourse, and two patient care floors of UK Albert B. Chandler Hospital’s new Pavilion A marked a historic milestone in achieving UK HealthCare’s mission of meeting the health care needs of Kentucky and beyond. Pavilion A is a facility of more than one million square feet, and is the cornerstone of a 20-year, \$2.5 billion plan to construct the Commonwealth Medical Campus of the Future. Among the campus’ components is a recently completed \$133.0 million Biological-Pharmacy Research Building with future plans for 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.** UK 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.

### **Financial Highlights**

The University's overall financial position remains fiscally sound with assets of \$3.77 billion and liabilities of \$1.14 billion as of June 30, 2011. Net assets, which represent the University's residual interest in assets after liabilities are deducted, were \$2.63 billion (70 percent of total assets.)

- Total assets increased \$230.2 million (seven percent), primarily due to increases in endowment investments, other long-term investments and net capital assets.
- Total liabilities decreased \$12.0 million (one percent), primarily due to the issuance of additional bonds, capital leases and other long-term obligations offset by payments of current year principal maturities on bonds and capital lease obligations and decreases in deferred revenues and self insurance liabilities.
- Total net assets increased \$242.2 million (ten percent) from June 30, 2010 to June 30, 2011. Unrestricted net assets decreased \$8.1 million as a result of expenses and transfers in excess of revenues primarily in UK HealthCare Hospital System, which saw a decrease as a result of the use of unrestricted net assets for construction of the new patient care facility; restricted net assets increased \$79.0 million largely due to investment gains on endowments; and capital assets, net of depreciation and related debt, increased \$171.3 million.
- Operating revenues were \$1.85 billion and operating expenses were \$2.20 billion, resulting in a loss from operations of \$344.9 million. Nonoperating and other revenues, net of nonoperating expenses, were \$587.1 million, including \$296.5 million in state appropriations.

### **Using the Financial Statements**

The University presents its financial reports in a "business type activity" format, in accordance with Governmental Accounting Standards Board Statement (GASB) 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*. GASB requires that statements be presented on a comprehensive, entity-wide basis. In addition to this MD&A section, the financial report includes:

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

### **Reporting Entity**

The University of Kentucky is a component unit of the Commonwealth of Kentucky. The 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 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.

## Statement of Net Assets

The 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, 2011, with comparative information as of June 30, 2010. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as noncurrent. Net assets (i.e. 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 as of June 30, 2011; June 30, 2010; and June 30, 2009 follows:

### Condensed Statements of Net Assets (in thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>ASSETS</b>			
Current assets	\$ 560,062	\$ 712,530	\$ 628,141
Capital assets, net of depreciation	1,909,171	1,773,855	1,571,530
Other noncurrent assets	1,305,623	1,058,256	1,046,614
Total Assets	<u>3,774,856</u>	<u>3,544,641</u>	<u>3,246,285</u>
<b>LIABILITIES</b>			
Current liabilities	337,123	346,363	313,083
Noncurrent liabilities	805,572	808,301	720,121
Total Liabilities	<u>1,142,695</u>	<u>1,154,664</u>	<u>1,033,204</u>
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	1,218,504	1,047,225	909,736
Restricted			
Nonexpendable	543,487	526,291	500,182
Expendable	263,424	201,624	176,433
Unrestricted	606,746	614,837	626,730
Total Net Assets	<u>\$ 2,632,161</u>	<u>\$ 2,389,977</u>	<u>\$ 2,213,081</u>

**Assets.** As of June 30, 2011, total assets amounted to \$3.77 billion. The largest asset class was investment in capital (net of depreciation) that totaled \$1.91 billion or 51 percent of total assets. Endowment investments were \$952.2 million, or 25 percent of total assets and cash and cash equivalents totaled \$379.8 million, or ten percent of total assets. During the year, total assets increased by a net \$230.2 million primarily because of an increase in endowment investments of \$158.7 million due to more favorable market conditions and an increase in capital additions of buildings and equipment.

**Liabilities.** As of June 30, 2011, total liabilities amounted to \$1.14 billion. Bonds and notes payable, capital leases and other long-term obligations issued for educational buildings, the housing and dining system, the UK HealthCare Hospital System, equipment and computer software totaled \$732.0 million, or 64 percent of total liabilities. During the year, total liabilities decreased by \$12.0 million as a result of principal payments on bonds and capital leases offset by the addition of new bonds and capital lease obligations primarily for the patient care facility and increases in other post employment benefit liabilities.

**Net Assets.** The University's equity of \$2.63 billion as of June 30, 2011 is reported on the Statement of Net Assets in four net asset categories: invested in capital assets, net of related debt, \$1.22 billion (46 percent); restricted-nonexpendable \$543.5 million (21 percent); restricted-expendable \$263.4 million (ten percent); and unrestricted \$606.7 million (23 percent).

Restricted net assets are subject to externally imposed restrictions governing their use. Although unrestricted net assets are not subject to externally imposed stipulations, most 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 \$242.2 million during the year ended June 30, 2011. Invested in capital assets, net of related debt increased \$171.3 million due to the additions of capital assets and principal payments of capital debt. Restricted net assets increased \$79.0 million principally as a result of gains on endowment investments due to a positive return on the endowment pool. Unrestricted net assets decreased \$8.1 million including a \$71.6 million decline in the UK HealthCare Hospital System and an increase of \$63.5 million from other University units and related organizations. UK HealthCare Hospital System's decrease in unrestricted net assets is primarily the result of the use of unrestricted net assets for construction of the new patient care facility.

**2010 Versus 2009.** During the year ended June 30, 2010:

- Total assets increased by a net \$298.4 million primarily due to an increase in capital additions of buildings and equipment of \$202.3 million. Additionally, endowment investments increased \$91.7 million due to favorable market conditions.
- Liabilities increased \$121.5 million primarily due to the issuance of additional debt, principally for the construction of the patient care facility.
- Total net assets increased \$176.9 million during the year ended June 30, 2010. Invested in capital assets, net of related debt, increased \$137.5 million due to the additions of capital assets and principal payments of capital debt. Restricted net assets increased \$51.3 million principally as a result of gains on endowment investments due to a positive return on the endowment pool. Unrestricted net assets decreased \$11.9 million including a \$41.0 million decrease in the UK HealthCare Hospital System and an increase of \$29.1 million in other University units and related organizations. UK HealthCare Hospital System's decrease in unrestricted assets is primarily the result of the use of unrestricted net assets for the construction of the new patient care facility.

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

The Statement of Revenues, Expenses and Changes in Net Assets is the University's income statement. It details how net assets have changed during the year ended June 30, 2011, with comparative information for the year ended June 30, 2010. 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. Items that increase or decrease net assets appear on the 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 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 external scholarships and institutional aid and is reported net of the scholarship allowance. A summarized comparison of the University's revenues, expenses and changes in net assets for years ended June 30, 2011; June 30, 2010; and June 30, 2009 follows.

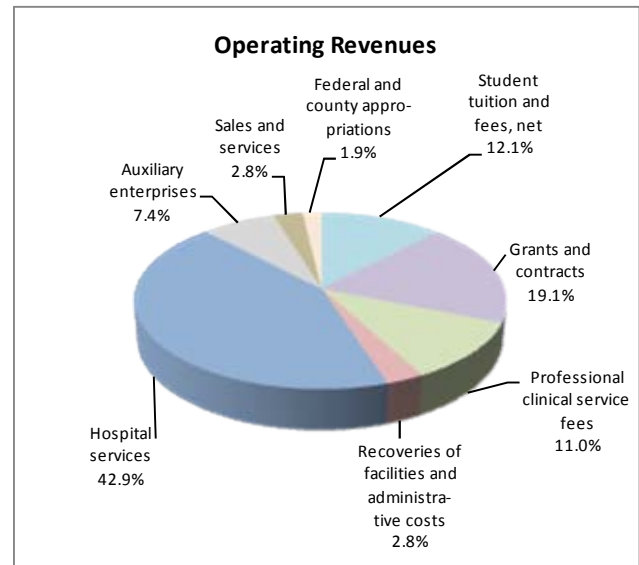
**Condensed Statements of Revenues, Expenses and Changes in Net Assets (in thousands)**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>OPERATING REVENUES</b>			
Student tuition and fees, net of scholarship allowances	\$ 223,366	\$ 208,340	\$ 195,244
Grants and contracts	352,450	294,294	275,468
Hospital services	794,085	782,677	701,936
Professional clinical service fees	202,767	194,401	193,391
Auxiliary enterprises, net of scholarship allowances	136,579	130,809	121,655
Recoveries of facilities and administrative costs	53,086	50,847	44,707
Sales and services	52,645	47,932	45,841
Federal and county appropriations	34,823	31,784	31,035
Other operating revenues	1,927	1,508	2,790
Total operating revenues	<u>1,851,728</u>	<u>1,742,592</u>	<u>1,612,067</u>
<b>OPERATING EXPENSES</b>			
Educational and general, excluding depreciation	1,093,930	1,038,891	989,251
Clinical operations, excluding depreciation	143,864	150,107	158,841
Hospital, excluding depreciation	721,832	702,029	667,994
Auxiliary enterprises, excluding depreciation	124,502	120,419	106,897
Depreciation	111,859	101,832	99,067
Other operating expenses	667	1,702	243
Total operating expenses	<u>2,196,654</u>	<u>2,114,980</u>	<u>2,022,293</u>
<b>NET LOSS FROM OPERATIONS</b>	<u>(344,926)</u>	<u>(372,388)</u>	<u>(410,226)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>			
State appropriations	296,472	294,137	315,162
State fiscal stabilization fund	17,224	21,067	-
Capital appropriations	12,477	11,450	3,446
Capital grants and gifts	29,337	42,992	107,546
Gifts and non-exchange grants	88,396	78,295	72,035
Investment income (loss)	147,940	95,428	(169,113)
Interest on capital asset-related debt	(22,550)	(19,024)	(15,862)
Additions to permanent endowments	16,338	21,062	9,990
Other, net	1,476	3,877	3,518
Total nonoperating revenues (expenses)	<u>587,110</u>	<u>549,284</u>	<u>326,722</u>
Total increase (decrease) in net assets	242,184	176,896	(83,504)
Net assets, beginning of year	<u>2,389,977</u>	<u>2,213,081</u>	<u>2,296,585</u>
Net assets, end of year	<u>\$2,632,161</u>	<u>\$2,389,977</u>	<u>\$2,213,081</u>

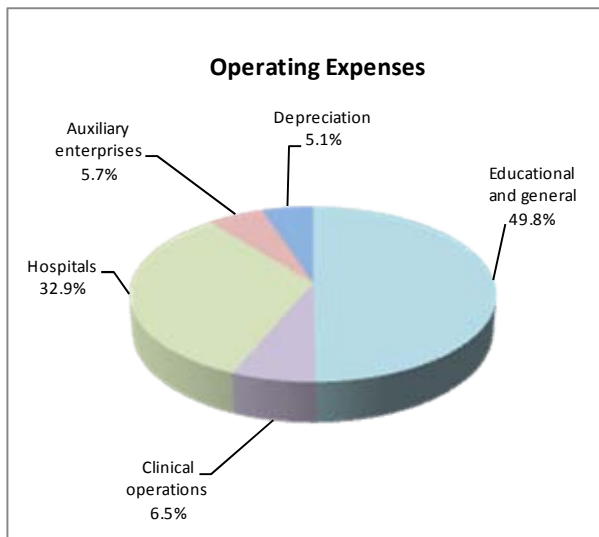


Total operating revenues were \$1.85 billion for the year ended June 30, 2011, an increase of \$109.1 million (six percent). The primary components of operating revenues were student tuition and fees of \$223.4 million; grants, contracts and recoveries of facilities and administrative costs of \$405.5 million; hospital services of \$794.1 million; and professional clinical fee income of \$202.8 million.

The major increase was in state and local grants and contracts of \$44.5 million, primarily caused by an increase in professional supplemental payments (PSP) from the state. Other significant increases in operating revenues related to net student tuition and fees of \$15.0 million due to tuition and fee rate increases as well as increased enrollment; federal grants of \$12.0 million resulting from the American Recovery and Reinvestment Act (ARRA) of 2009; and hospital service revenue of \$11.4 million resulting from increases in rates, an overall increase in the case mix index and increased outpatient visits. Professional clinical service fees increased \$8.4 million due to fee schedule increases and volume.



Operating expenses totaled \$2.20 billion, an increase of \$81.7 million (four percent). Of this amount, \$1.09 billion (excluding depreciation) was expended for educational and general programs, including instruction, research and public service. Hospital System expenses, excluding depreciation, amounted to \$721.8 million and clinical operations expenses, excluding depreciation, were \$143.9 million. Depreciation expense for the year amounted to \$111.9 million.



The most significant increase was in public service of \$50.4 million primarily due to the increase in professional supplemental payments funding this category as stated above. Hospital System expenses, excluding depreciation, increased \$19.8 million while instruction and research expenses increased \$11.9 million and \$7.0 million respectively. Instruction expenses increased primarily due to new faculty in the College of Arts and Sciences and the College of Communications to implement the University's General Education Reform and increased benefit costs. Depreciation expenses increased \$10.0 million due primarily to the addition of capital assets.

The net loss from operations for the year was \$344.9 million. Nonoperating and other revenues, net of expenses, totaled \$587.1 million and included: state appropriations of \$296.5 million – an increase of \$2.3 million; state fiscal stabilization funds of \$17.2 million – a decrease of \$3.8 million; investment income of \$147.9 million – an increase of \$52.5 million; gifts and non-exchange grants of \$88.4 million – an increase of \$10.1 million; and capital gifts and grants of \$29.3 million – a decrease of \$13.7 million.

**2010 Versus 2009.** Total operating revenues were \$1.74 billion for the year ended June 30, 2010, including: student tuition and fees of \$208.3 million (12 percent); grants, contracts, and recoveries of facilities and administrative costs of \$345.1 million (20 percent); professional clinical service fees of \$194.4 million (11 percent); and hospital services of \$782.7 million (45 percent). Operating revenues for fiscal year 2010 increased \$130.5 million or eight percent over fiscal year 2009, primarily due to increases in hospital services revenues of \$80.7 million; student tuition and fees of \$13.1 million; federal grants of \$ 16.8 million from the American Recovery and

Reinvestment Act of 2009 and recoveries of facilities and administrative costs of \$6.1 million due to the increase in grants.

Operating expenses totaled \$2.11 billion in fiscal year 2010. Of this amount, \$1.04 billion, or 49 percent excluding depreciation, was expended for educational and general programs, including instruction, research and public service. Hospital expenses, excluding depreciation, totaled \$702.0 million, or 33 percent of the total expenses, and clinical operations expenses, excluding depreciation, were \$150.1 million (seven percent). Depreciation amounted to \$101.8 million (five percent). Operating expenses for fiscal year 2010 increased \$92.7 million (five percent) over fiscal year 2009 primarily due to increases in hospital expenses, excluding depreciation, of \$34.0 million (five percent). Instruction and research expenses increased \$13.8 million (six percent) and \$12.9 million (five percent) respectively. Depreciation expense increased \$2.8 million or three percent, due primarily to the addition of related capital assets.

The net loss from operations for the 2010 fiscal year totaled \$372.4 million. Nonoperating and other revenues, net of expenses, totaled \$549.3 million, resulting in an increase in net assets of \$176.9 million for the year. Nonoperating revenue included state appropriations of \$294.1 million, which decreased \$21.0 million from June 30, 2009 to June 30, 2010, offset by an increase of \$21.1 million in state stabilization fund and investment income of \$95.4 million.

### **Statement of Cash Flows**

The Statement of Cash Flows details how cash has increased or decreased during the fiscal year ended June 30, 2011, with comparative financial information for the fiscal year ended June 30, 2010. The sources and uses of cash are arranged in 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 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 University's ability to generate future net cash flows and to meet obligations as they become due; and to assess the possible need for external financing.

A comparative summary of the University's statement of cash flows for years ended June 30, 2011; June 30, 2010; and June 30, 2009 follows:

**Condensed Statement of Cash Flows (in thousands)**

	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>CASH PROVIDED (USED) BY:</b>			
Operating activities	\$ (228,807)	\$ (257,232)	\$ (307,813)
Noncapital financing activities	449,513	436,216	401,342
Capital and related financing activities	(255,258)	(191,256)	(226,694)
Investing activities	(78,944)	64,000	(3,819)
Net increase (decrease) in cash and cash equivalents	(113,496)	51,728	(136,984)
<b>Cash and cash equivalents, beginning of year</b>	<b>493,282</b>	<b>441,554</b>	<b>578,538</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 379,786</b>	<b>\$ 493,282</b>	<b>\$ 441,554</b>

The University's cash and cash equivalents decreased \$113.5 million in fiscal year 2011. Total cash provided by operating and noncapital financing activities was \$220.7 million, an increase of \$41.7 million compared to fiscal year 2010. Total cash used by capital financing activities was \$255.3 million, reflecting both capital funding sources (debt proceeds) and uses (purchases of capital assets and debt service). Total cash used by investing activities was \$78.9 million.

Major sources of cash received from operating activities were student tuition and fees of \$222.6 million; hospital services of \$793.2 million; grants, contracts, and recoveries of facilities and administrative costs of \$421.5 million; and professional clinical service fees of \$200.4 million. Major uses of cash for operating activities were payments to employees for salaries and benefits of \$1.38 billion and to vendors and contractors of \$677.9 million.

Noncapital financing activities include state appropriations from the Commonwealth of Kentucky of \$296.5 million; state fiscal stabilization funds of \$17.2 million; and gifts of \$103.4 million.

Capital and related financing activities include proceeds of capital debt of \$31.7 million, capital appropriations of \$12.5 million, and capital grants and gifts of \$32.2 million. Cash of \$240.6 million was expended for construction and acquisition of capital assets and \$93.4 million was expended for principal and interest payments on debt.

Investing activities include proceeds from sales and maturities of investments of \$967.3 million and interest and dividends on investments of \$8.2 million. Cash of \$1.05 billion was used to purchase investments.

**2010 Versus 2009.** Cash balances are higher when comparing fiscal year 2010 to fiscal year 2009. The \$51.7 million net increase in cash was created from more cash provided by noncapital and investing activities and less cash used by operating and for capital related activities.

## Capital Asset and Debt Administration

### Capital Assets

Capital assets, net of accumulated depreciation, totaled \$1.91 billion at June 30, 2011, an increase of \$135.3 million. Capital assets as of June 30, 2011 and significant changes in capital assets during the years ended June 30, 2009; June 30, 2010; and June 30, 2011 follow (in millions):

	Balance June 30, 2009	Net Additions FY 09-10	Balance June 30, 2010	Net Additions FY 10-11	Balance June 30, 2011
Land and land improvements	\$ 138	\$ 5	\$ 143	\$ 17	\$ 160
Buildings, fixed equipment and infrastructure	1,517	150	1,667	491	2,158
Equipment, vehicles and capitalized software	570	19	589	36	625
Library materials and art	152	3	155	-	155
Construction in progress	341	103	444	(324)	120
Accumulated depreciation	<u>(1,146)</u>	<u>(78)</u>	<u>(1,224)</u>	<u>(85)</u>	<u>(1,309)</u>
<b>Total</b>	<b><u>\$ 1,572</u></b>	<b><u>\$ 202</u></b>	<b><u>\$ 1,774</u></b>	<b><u>\$ 135</u></b>	<b><u>\$ 1,909</u></b>

At June 30, 2011, the University had capital construction projects in progress totaling approximately \$224.8 million in scope. Major projects include the continuing construction of the Patient Care Facility, Veterinary Diagnostic Laboratory expansion, fit-up of the new Pharmacy Building, Guaranteed Energy Savings Performance Contract, Center for Applied Energy Research laboratory and Digital Village. The estimated cost to complete the projects in progress is approximately \$100.6 million.

### Debt

At June 30, 2011, capital debt amounted to \$732.0 million, summarized by trust indenture and type as follows (in millions):

	2011	2010	2009
General Receipts bonds and notes	\$ 491.3	\$ 481.5	\$ 390.9
Consolidated Educational Buildings Revenue Bonds	82.8	93.6	104.8
Capital lease obligations	133.9	153.2	154.5
Notes payable	24.0	25.9	26.8
<b>Total</b>	<b><u>\$ 732.0</u></b>	<b><u>\$ 754.2</u></b>	<b><u>\$ 677.0</u></b>

Debt decreased \$22.2 million during the year primarily due to the principal payments of \$62.0 million for the University's debt obligations which was partially offset by the issuance of bonds (\$25.3 million) for the campus energy conservation project.

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

Executive management believes 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:

- The 2010-12 biennial budget passed by the 2010 General Assembly in May 2010 reflected a net 1.0 percent reduction, or \$3.1 million, in state support for the University in fiscal year 2012. The budget was subsequently amended by the 2011 General Assembly in March 2011 to increase the University's state support by \$5.9 million in fiscal year 2011 and reduced state support by the same amount in fiscal year 2012. This movement of funds was necessary for the Commonwealth to meet the federal maintenance of effort requirements for the Education Jobs Fund program. As a result of these actions, the University's state support for fiscal year 2011, including the federal State Fiscal Stabilization Funds was \$313.7 million and the University's fiscal year 2012 state support is expected to be \$297.6 million. The \$5.9 million movement of funds is expected to be a one-time occurrence and to be restored in fiscal year 2013.
- Tuition rates for fiscal year 2011-12 will generally increase six percent. The tuition rate increases, along with adjustments for projected enrollment, are expected to generate additional operating revenues of approximately \$27.9 million compared to the fiscal year 2010-11 original budget.
- As of June 30, 2011, grants and contracts of approximately \$411.3 million have been awarded to the University but not expended. These contracts will provide grant revenue in future periods.
- The new Patient Care Facility building with an estimated construction cost of \$575.6 million was authorized by the General Assembly and approved by the Board of Trustees. The emergency department, lobby, concourse and two patient floors opened in FY 2010-11. Work is progressing on the second phase of the project to include eight operating rooms, a hybrid suite, and related post anesthesia and recovery unit, with scheduled completion in December 2011. General Receipts notes and bonds in the amount of \$366.3 million have been issued for this project with the remainder of the funding being provided by UK HealthCare Hospital System cash reserves.
- Healthcare reform has initiated significant changes to the United States healthcare system, including potential material changes to the delivery of healthcare services and the reimbursement paid for such services by the government or other third-party payers. The long-term impact is unknown, as the long period between passage and its implementation lends to some level of uncertainty. UK Healthcare will develop and execute strategies in an effort to mitigate the negative impacts and leverage opportunities.
- On July 7, 2011, Governor Steve Beshear announced that the state had enacted contracts with three new Managed Care Organizations (MCO's) to provide services to Medicaid recipients across the state, except for recipients receiving long-term care and waiver services. UK HealthCare is in the midst of negotiating provider contracts with the new MCO's.
- 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.

Economic challenges will continue to have an impact on the future. However, management believes the University of Kentucky will be able to sustain its sound financial position and continue its progress toward becoming one of America's premier public research institutions.



UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
STATEMENTS OF NET ASSETS (in thousands)  
JUNE 30, 2011 AND 2010

	2011	2010
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 302,838	\$ 448,967
Notes, loans and accounts receivable, net	212,179	224,138
Investments	10,989	6,404
Inventories and other assets	34,056	33,021
Total current assets	<u>560,062</u>	<u>712,530</u>
<b>Noncurrent Assets</b>		
Restricted cash and cash equivalents	76,948	44,315
Endowment investments	952,248	793,505
Other long-term investments	212,592	149,858
Notes, loans and accounts receivable, net	44,104	51,446
Other noncurrent assets	19,731	19,132
Capital assets, net	1,909,171	1,773,855
Total noncurrent assets	<u>3,214,794</u>	<u>2,832,111</u>
Total assets	<u>3,774,856</u>	<u>3,544,641</u>
<b>LIABILITIES</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	190,296	191,318
Deferred revenue	68,625	66,209
Long-term liabilities - current portion	78,202	88,836
Total current liabilities	<u>337,123</u>	<u>346,363</u>
<b>Noncurrent Liabilities</b>		
Accounts payable and accrued liabilities	398	2,659
Deferred revenue	-	6,387
Long-term liabilities	805,174	799,255
Total noncurrent liabilities	<u>805,572</u>	<u>808,301</u>
Total liabilities	<u>1,142,695</u>	<u>1,154,664</u>
<b>NET ASSETS</b>		
<b>Invested in capital assets, net of related debt</b>	<u>1,218,504</u>	<u>1,047,225</u>
<b>Restricted</b>		
Nonexpendable		
Scholarships and fellowships	121,096	111,378
Research	257,830	248,538
Instruction	73,387	75,169
Academic support	83,388	83,159
Other	7,786	8,047
Total restricted nonexpendable	<u>543,487</u>	<u>526,291</u>
Expendable		
Scholarships and fellowships	54,513	36,136
Research	46,636	16,777
Instruction	40,468	26,809
Academic support	31,348	16,306
Loans	9,885	9,525
Capital projects	42,049	53,149
Debt service	5,859	6,374
Auxiliary	11,102	10,153
Other	21,564	26,395
Total restricted expendable	<u>263,424</u>	<u>201,624</u>
Total restricted	<u>806,911</u>	<u>727,915</u>
<b>Unrestricted</b>	<u>606,746</u>	<u>614,837</u>
Total net assets	<u>\$ 2,632,161</u>	<u>\$ 2,389,977</u>

**UNIVERSITY OF KENTUCKY**  
**A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (in thousands)**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	2011	2010
<b>OPERATING REVENUES</b>		
Student tuition and fees	\$ 305,918	\$ 281,848
Less: Scholarship allowances	(82,552)	(73,508)
Net tuition and fees	223,366	208,340
Federal grants and contracts	186,307	174,297
State and local grants and contracts	138,089	93,601
Nongovernmental grants and contracts	28,054	26,396
Recoveries of facilities and administrative costs	53,086	50,847
Sales and services	52,645	47,932
Federal appropriations	16,606	15,390
County appropriations	18,217	16,394
Professional clinical service fees	202,767	194,401
Hospital services	794,085	782,677
Auxiliary enterprises:		
Housing and dining	50,654	46,991
Less: Scholarship allowances	(7,391)	(6,613)
Net housing and dining	43,263	40,378
Athletics	66,527	63,652
Other auxiliaries	26,789	26,779
Other operating revenues	1,927	1,508
Total operating revenues	<u>1,851,728</u>	<u>1,742,592</u>
<b>OPERATING EXPENSES</b>		
Educational and general:		
Instruction	266,031	254,120
Research	271,292	264,250
Public service	274,983	224,560
Libraries	19,917	18,961
Academic support	81,158	77,800
Student services	30,980	28,970
Institutional support	55,231	81,139
Operations and maintenance of plant	65,601	62,056
Student financial aid	28,737	27,035
Depreciation	69,802	64,365
Total educational and general	1,163,732	1,103,256
Clinical operations (including depreciation of \$2,412 in 2011 and \$2,201 in 2010)	146,276	152,308
Hospital and clinics (including depreciation of \$35,500 in 2011 and \$31,694 in 2010)	757,332	733,723
Auxiliary enterprises:		
Housing and dining (including depreciation of \$3,612 in 2011 and \$3,017 in 2010)	43,777	39,980
Athletics (including depreciation of \$533 in 2011 and \$555 in 2010)	65,986	67,556
Other auxiliaries	18,884	16,455
Other operating expenses	667	1,702
Total operating expenses	<u>2,196,654</u>	<u>2,114,980</u>
Net loss from operations	<u>(344,926)</u>	<u>(372,388)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
State appropriations	296,472	294,137
State fiscal stabilization fund	17,224	21,067
Gifts and non-exchange grants	88,396	78,295
Investment income (loss)	147,940	95,428
Interest on capital asset-related debt	(22,550)	(19,024)
Other nonoperating revenues and expenses, net	7,152	5,387
Net nonoperating revenues (expenses)	<u>534,634</u>	<u>475,290</u>
Net income (loss) before other revenues, expenses, gains or losses	<u>189,708</u>	<u>102,902</u>
Capital appropriations	12,477	11,450
Capital grants and gifts	29,337	42,992
Additions to permanent endowments, including Research Challenge		
Trust Funds of \$340 in 2011 and \$11,061 in 2010	16,338	21,062
Other, net	(5,676)	(1,510)
Total other revenues (expenses)	<u>52,476</u>	<u>73,994</u>
<b>INCREASE IN NET ASSETS</b>	242,184	176,896
<b>NET ASSETS, beginning of year</b>	<u>2,389,977</u>	<u>2,213,081</u>
<b>NET ASSETS, end of year</b>	<u>\$ 2,632,161</u>	<u>\$ 2,389,977</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY**  
**A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY**  
**STATEMENTS OF CASH FLOWS (in thousands)**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Student tuition and fees	\$ 222,625	\$ 206,948
Grants and contracts	365,564	282,370
Recoveries of facilities and administrative costs	55,906	49,227
Sales and services	54,395	53,315
Federal appropriations	18,076	12,697
County appropriations	17,320	16,475
Payments to vendors and contractors	(677,925)	(664,911)
Student financial aid	(28,729)	(27,023)
Salaries, wages and benefits	(1,378,354)	(1,300,914)
Professional clinic service fees	200,401	195,183
Hospital services	793,157	780,352
Auxiliary enterprise receipts:		
Housing and Dining	43,547	40,419
Athletics	66,034	64,643
Other auxiliaries	26,047	26,589
Loans issued to students	(23,999)	(16,561)
Collection of loans to students	24,226	18,576
Self insurance receipts	62,505	53,111
Self insurance payments	(68,526)	(49,029)
Other operating receipts (payments), net	(1,077)	1,301
Net cash provided (used) by operating activities	<u>(228,807)</u>	<u>(257,232)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
State appropriations	296,472	294,137
State fiscal stabilization fund	17,224	21,067
Gifts and grants received for other than capital purposes:		
Gifts received for endowment purposes	16,338	21,062
Gifts received for other purposes	87,081	79,333
Agency and loan program receipts	186,472	149,302
Agency and loan program payments	(185,221)	(149,302)
Other noncapital financing receipts (payments), net	31,147	20,617
Net cash provided (used) by noncapital financing activities	<u>449,513</u>	<u>436,216</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Capital appropriations	12,476	11,450
Capital grants and gifts	32,167	36,787
Purchases of capital assets	(240,555)	(283,536)
Proceeds from capital debt	31,734	125,379
Proceeds from sales of capital assets	3	-
Principal paid on capital debt and leases	(59,447)	(49,664)
Interest paid on capital debt and leases	(33,964)	(30,776)
Other capital and related financing receipts (payments), net	2,328	(896)
Net cash provided (used) by capital and related financing activities	<u>(255,258)</u>	<u>(191,256)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales and maturities of investments	967,265	1,268,373
Interest and dividends on investments	8,183	22,386
Purchase of investments	(1,054,392)	(1,226,759)
Net cash provided (used) by investing activities	<u>(78,944)</u>	<u>64,000</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<u>(113,496)</u>	<u>51,728</u>
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>493,282</u>	<u>441,554</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 379,786</u>	<u>\$ 493,282</u>
<b>Reconciliation of net loss from operations to net cash used by operating activities:</b>		
Net loss from operations	\$ (344,926)	\$ (372,388)
Adjustments to reconcile net loss from operations to net cash used by operating activities:		
Depreciation expense	111,859	101,832
Change in assets and liabilities:		
Notes, loans and accounts receivable, net	13,296	(12,302)
Inventories and other assets	(3,477)	3,581
Accounts payable and accrued liabilities	3,725	16,627
Deferred revenue	(2,748)	(2,466)
Long-term liabilities	(6,536)	7,884
<b>Net cash provided (used) by operating activities</b>	<u>\$ (228,807)</u>	<u>\$ (257,232)</u>

**UNIVERSITY OF KENTUCKY**  
**A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY**  
**NOTES TO 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 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 Statutes (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 Gluck Equine Research Foundation, Inc.; University of Kentucky Humanities Foundation, Inc.; and University of Kentucky Center on Aging Foundation, Inc. The 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. The financial statements also include the operations of the UK HealthCare Hospital System (the System), an organizational unit of the University. The separate financial statements for the above entities can be found at: [www.uky.edu/evpfa/controller/finst](http://www.uky.edu/evpfa/controller/finst).

The University of Kentucky Business Partnership Foundation, Inc. (the Foundation) was dissolved on June 30, 2010. All assets held by the Foundation were transferred to the University according to the Articles of Dissolution of the University of Kentucky Business Partnership Foundation, Inc. on July 1, 2010.

**Basis of Presentation**

The accompanying 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.

Pursuant to GASB Statement No. 20, the University has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989 and do not conflict with or contradict GASB pronouncements.

### **Summary of Significant Accounting Policies**

Accrual Basis. The 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 include plant funds allocated for capital projects, debt service reserves and endowment fund cash pending transfer to the custodian for investment. Cash and cash equivalents held by bond trustees and the University's endowment fund managers are included in investments.

Notes, Loans and Accounts Receivable. This classification consists of tuition and fee charges to students, charges for auxiliary enterprise services provided to students, faculty and staff, and loans to students. Also included are patient accounts receivable, amounts due from sponsors for reimbursement of expenses made pursuant to contracts and grants, and pledges that are verifiable, measurable and expected to be collected. Accounts receivable are recorded net of estimated uncollectible amounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

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

Pooled Endowment Funds. All endowments are managed in a consolidated investment pool, which consists of more than 2,000 named funds. All contributing endowments participate in the income and appreciation of the pool on a per unit basis commensurate with their contribution to the pool. New endowments purchase units in the pool at the current unit value, which is calculated each month based on the fair value of the pool investments divided by the number of pool units outstanding. 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.

In accordance with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), as adopted by the Commonwealth of Kentucky in July 2010, the University employs a total return method for establishing investment objectives and spending policies designed to achieve financial equilibrium for endowment funds over the long term. Prior to the passage of UPMIFA, the University was subject to the Uniform Management of Institutional Funds Act (UMIFA), as adopted by the Commonwealth of Kentucky, which also allowed for total return management.

The University utilizes a spending policy designed to smooth spending distributions and protect endowed programs from market volatility by calculating distributions based on a percentage of the average market value of the endowment over a specified period of time. The University has made expenditure decisions in accordance with prevailing UPMIFA or UMIFA statutes and donor gift agreements. UPMIFA allows institutions to appropriate for expenditure the amount of an endowment fund the institution deems is prudent based on a review of various factors set forth in the Act, subject to terms set forth in a gift agreement. UMIFA allowed institutions to appropriate for expenditure a prudent amount of realized and unrealized gains over the historic dollar value of an endowment fund, also subject to terms set forth in a gift agreement.

For the year ended June 30, 2011 the University's endowment spending rule provided for annual distributions of 4.375 percent of the 60 month moving average market value of fund units. For the year ended June 30, 2010, the University's endowment spending rule provided for annual distributions of 4.5 percent of the thirty-six month moving average market value of fund units. For the years ended June 30, 2011 and 2010 approximately \$22,409,000 and \$24,084,000, respectively, was transferred from endowment realized and



unrealized gains or losses to support current programs in accordance with the University's endowment spending rule. Additionally, for the year ended June 30, 2011, the University assessed eligible endowment accounts with a management fee of 0.375 percent of total asset value. For the year ended June 30, 2010, the University assessed eligible endowment accounts with a management fee of 0.5 percent of total asset value.

The Investment Committee of the University's Board of Trustees has approved a spending rate distribution of 4.25 percent of a 60 month moving average market value of fund units for the year ended June 30, 2012. Additionally, the Investment Committee has approved a management fee of 0.25 percent for the year ended June 30, 2012.

Investments. Investments in marketable debt and equity 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. Other investments, including guaranteed investment contracts, repurchase agreements and certificates of deposit are valued at face value and are fully collateralized.

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.

The University capitalizes interest costs as a component of construction in progress based on the interest cost of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing.

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. Institutional software costing more than \$400,000 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 improvements, building improvements and infrastructure, 10 years for library books and capitalized software, and 5 – 20 years for equipment and vehicles.

The University capitalizes, but does not depreciate, works of art, historical treasures and certain library materials 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 and amounts received from the federal government through the Commonwealth of Kentucky for Disproportionate Share System (DSH) funds. 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. Deferred revenue is recognized in the period to which the grant, event or semester relates. The DSH amounts are recognized as revenue over the term of the federal government fiscal year, October 1 – September 30.

Compensated Absences. The amount of vacation leave earned but not taken by employees at June 30, 2011 is recorded as a liability by the University. Temporary disability leave payable upon termination under the University's payout policy is also recorded as a liability. Compensated absence liabilities are computed using the pay rates in effect at the statement of net assets date plus an additional amount for compensation-related payments such as Social Security and Medicare taxes computed using rates in effect at that date.

Scholarship Allowances. 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. Scholarship allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants and other federal and state programs similar to Pell, are recorded as nonoperating revenues; other governmental and nongovernmental grants are recorded as operating revenues in the University's financial statements. To the extent that revenues from such

programs are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship allowance.

Hospital and Clinical Services Revenues. Hospital and clinical services revenues are reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including contractual allowances and estimated retroactive adjustments under reimbursement programs with third-party payers, less an allowance for doubtful accounts. 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.

Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. Certain inpatient nonacute services and defined medical education costs are paid based on a cost reimbursement methodology. The System is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary.

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for all other services. The System is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicaid fiscal intermediary.

Revenue from the Medicare and Medicaid programs accounted for approximately 25 percent and 24 percent, respectively, of the System's net patient services revenues (before the provision for doubtful accounts) for the year ended June 30, 2011 and approximately 24 percent for both, for the year ended June 30, 2010. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The System also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Since the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

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, as amended. 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 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 nonoperating revenues in accordance with GASB Statement No. 35.

The University has classified operating expenses based upon their functional classifications. Operating expenses by natural classification are presented in Note 23. During fiscal years 2011 and 2010, departmental research in nonsponsored accounts of \$64,465,000 and \$63,136,000, respectively, was recorded as research expense in the Statements of Revenues, Expenses and Changes in Net Assets.

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, estimated third-party payer settlements, self-insurance reserves, accrued expenses and other liability accounts.

Recent Accounting Pronouncements. The GASB has issued certain statements which are applicable to the University for fiscal years ending after June 30, 2011. The University does not expect the adoption of these statements to have a material effect on its financial statements.

## 2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2011 and 2010 is as follows (in thousands):

	2011	2010
Deposits with banks and the Commonwealth of Kentucky	\$ 32,339	\$ 33,291
U.S. Treasury fixed income securities	13,999	45,696
Government agency fixed income securities	118,422	43,559
Common and preferred stocks	58,149	12,177
Pooled equity funds	358,090	383,165
Private equity funds	46,228	29,276
Pooled absolute return funds	180,548	78,460
Pooled real return funds	97,861	55,749
Pooled real estate funds	52,245	54,466
Pooled fixed income funds	392,650	459,604
Corporate fixed income securities	22,122	36,344
Guaranteed investment contracts	323	509
Repurchase agreements	128,319	155,027
Certificates of deposit	19,245	12,795
Cash and cash equivalents	34,295	42,584
Other	780	347
	\$ 1,555,615	\$ 1,443,049
	2011	2010
Statement of Net Assets classification		
Cash and cash equivalents	\$ 302,838	\$ 448,967
Current investments	10,989	6,404
Restricted cash and cash equivalents	76,948	44,315
Endowment investments	952,248	793,505
Other long-term investments	212,592	149,858
	\$ 1,555,615	\$ 1,443,049

**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 Vice President for Financial Operations and Treasurer of the University. 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 including: 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 include deposits, money markets and repurchase agreements with local banks, the Commonwealth of Kentucky and other financial institutions.
- 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 Overnight and Short-Term Investment Policy approved 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 Policy.

**Deposit and investment risks.** The University's deposits and investments are exposed to various risks, including credit, interest rate and foreign currency risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could affect the investment amounts in the statement of net assets.

**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 for balances exceeding amounts covered by the Federal Deposit Insurance Corporation. On November 9, 2010, the FDIC Board of Directors issued a final rule to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that provides temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts at all FDIC-insured depository institutions. The separate coverage for noninterest-bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012. The University's deposits are non-interest bearing and are fully insured by FDIC coverage. 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 percent of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth. Money market fund portfolios consist of securities eligible for short-term investments.
- 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 ten percent); 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 U.S. treasury securities; securities issued by U.S. government agencies or government sponsored entities; money market securities, including: commercial paper rated the highest by a nationally recognized rating agency, collateralized certificates of deposit, and bankers' acceptances for banks rated A or higher; repurchase and reverse repurchase agreements collateralized at 102 percent; municipal obligations rated A1 or higher; and money market mutual funds invested in any of the above noted security types. 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 managers are permitted to use derivative instruments to limit credit risk. Additionally, 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, 2011 and 2010, respectively, the credit quality of the University's fixed income investments is as follows (in thousands):

	2011								Total
	S&P/Moody's Credit Ratings							Rating Not Applicable	
	AAA/Aaa	AA/Aa	A	BBB/Baa	BB/Ba	B	Not rated		
U.S. treasury fixed income								\$ 13,999	\$ 13,999
Government agency fixed income	\$ 118,422							-	118,422
Pooled fixed income	936	\$ 565	\$ 79	\$ 145		\$ 738	\$ 390,187	-	392,650
Corporate fixed income	-	107	11,644	10,371		-	-	-	22,122
Guaranteed investment contracts	-	-	-	-		-	323	-	323
Repurchase agreements	-	-	-	-		-	128,319	-	128,319
Certificates of deposit	-	-	-	-		-	19,245	-	19,245
Cash and cash equivalents	3,511	-	-	-		-	30,784	-	34,295
Total fixed income investments	\$ 122,869	\$ 672	\$ 11,723	\$ 10,516	\$ -	\$ 738	\$ 568,858	\$ 13,999	\$ 729,375

	2010								Total
	S&P/Moody's Credit Ratings							Rating Not Applicable	
	AAA/Aaa	AA/Aa	A	BBB/Baa	BB/Ba	B	Not rated		
U.S. treasury fixed income								\$ 45,696	\$ 45,696
Government agency fixed income	\$ 43,559							-	43,559
Pooled fixed income	1,873	\$ 28					\$ 457,703	-	459,604
Corporate fixed income	-	392	\$ 1,162	\$ 34,789			1	-	36,344
Guaranteed investment contracts	-	-	-	-			509	-	509
Repurchase agreements	-	-	-	-			155,027	-	155,027
Certificates of deposit	-	-	-	-			12,795	-	12,795
Cash and cash equivalents	17,690	-	-	-			24,894	-	42,584
Total fixed income investments	\$ 63,122	\$ 420	\$ 1,162	\$ 34,789	\$ -	\$ -	\$ 650,929	\$ 45,696	\$ 796,118

**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 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. Money market investments are held in the University's name by the University's custodian.
- Bond revenue fund investments held in the Commonwealth's investment pools are held in the Commonwealth's name by the Commonwealth's custodian.
- Short-term investments held by the Commonwealth for the benefit of the University are invested in the Commonwealth's investment pools and are held in the name of the Commonwealth 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, 2011 and 2010, respectively, 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):

	2011					Total
	State Deposits	Overnight Investments	Bond Revenue Investments	Short-term Investments	Other State Investments	
Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the University's name		\$ 112,000				\$ 112,000
Uninsured, not registered in the name of the University and held by the counterparty but not in the University's name		-	\$ 67,510	\$ 60,311	\$ 138,973	266,794
Total	\$ -	\$ 112,000	\$ 67,510	\$ 60,311	\$ 138,973	\$ 378,794

	2010					Total
	State Deposits	Overnight Investments	Bond Revenue Investments	Short-term Investments	Other State Investments	
Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the University's name	\$ 33,291	\$ 148,000				\$ 181,291
Uninsured, not registered in the name of the University and held by the counterparty but not in the University's name	-	-	\$ 228,975	\$ 60,318	\$ 73,718	363,011
Total	\$ 33,291	\$ 148,000	\$ 228,975	\$ 60,318	\$ 73,718	\$ 544,302

**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 deposits and repurchase agreements are not limited as to the maximum amount that may be invested in one issuer. However, all such deposits 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 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 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, other than the requirement that the amount of money invested at any one time in commercial paper, bankers' acceptances and municipal obligations shall not exceed 20 percent.
- 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 fixed income managers are limited to a maximum investment in any one issuer of no more than five percent of total investments.

At June 30, 2011 and 2010, the University has no investments in any one issuer, other than U.S. treasury and/or agency securities, that represent five 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, money markets 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 three years.
- Short-term investments managed by the University are generally 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 managers are permitted to use derivative instruments to limit interest rate risk. Additionally, endowment investments held by fixed income managers are limited to a duration that is within +/-25 percent of the duration of the Barclays Aggregate Bond Index.

For June 30, 2011 and 2010, respectively, below is the maturity distribution of the University's fixed income investments (in thousands):

<u>Investment Type</u>	2011						Total
	<u>Maturities in Years</u>					Managed based on duration	
	Less than 1	1-3	3-5	5-10	Greater than 10		
U.S. treasury fixed income	\$ 6,273	\$ 60	\$ 9	\$ 88		\$ 7,569	\$ 13,999
Government agency fixed income	40,053	60,644	360	277		17,088	118,422
Pooled fixed income	-	-	-	-		392,650	392,650
Corporate fixed income	-	316	1,151	-		20,655	22,122
Guaranteed investment contracts	-	100	223	-		-	323
Repurchase agreements	123,348	-	1,014	3,957		-	128,319
Certificates of deposit	19,245	-	-	-		-	19,245
Cash and cash equivalents	34,295	-	-	-		-	34,295
<b>Total fixed income investments</b>	<b>\$ 223,214</b>	<b>\$ 61,120</b>	<b>\$ 2,757</b>	<b>\$ 4,322</b>	<b>\$ -</b>	<b>\$ 437,962</b>	<b>\$ 729,375</b>

<u>Investment Type</u>	2010						Total
	<u>Maturities in Years</u>					Managed based on duration	
	Less than 1	1-3	3-5	5-10	Greater than 10		
U.S. treasury fixed income	\$ 10,659	\$ 59		\$ 94		\$ 34,884	\$ 45,696
Government agency fixed income	10,143	10,347	\$ 6,770	325		15,974	43,559
Pooled fixed income	-	-	-	-		459,604	459,604
Corporate fixed income	333	317	710	533		34,451	36,344
Guaranteed investment contracts	150	100	259	-		-	509
Repurchase agreements	150,086	-	-	1,008	\$ 3,933	-	155,027
Certificates of deposit	12,795	-	-	-	-	-	12,795
Cash and cash equivalents	42,584	-	-	-	-	-	42,584
<b>Total fixed income investments</b>	<b>\$ 226,750</b>	<b>\$ 10,823</b>	<b>\$ 7,739</b>	<b>\$ 1,960</b>	<b>\$ 3,933</b>	<b>\$ 544,913</b>	<b>\$ 796,118</b>



At June 30, 2011 and 2010, the University had the following investments managed based on duration (in thousands):

<u>Investment Type</u>	<u>2011</u>		<u>2010</u>	
	<u>Fair Value</u>	<u>Modified Duration (Years)</u>	<u>Fair Value</u>	<u>Modified Duration (Years)</u>
U.S. treasury fixed income securities				
Pooled endowment fund	\$ 7,569	7.14	\$ 34,884	0.91
Government agency fixed income securities				
Pooled endowment fund	17,088	4.10	15,974	0.43
Pooled fixed income funds				
Pooled endowment fund	123,393	4.39	94,690	4.97
Other endowment investments	2,463	5.45	1,873	4.94
Commonwealth of Kentucky short-term pool	191,276	0.06	289,287	0.10
Commonwealth of Kentucky intermediate pool	75,518	1.21	73,725	0.82
KTI	-	-	29	4.20
Corporate fixed income securities				
Pooled endowment fund	20,655	3.33	34,451	1.49
Total	<u>\$ 437,962</u>		<u>\$ 544,913</u>	

**Foreign Currency Risk.** Foreign currency risk is the risk that fluctuations 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 endowment investments. The University's endowment investment policy allows fixed income managers to invest a portion of their portfolios in non-U.S. securities. Additionally, the investment policy allows various pooled fund managers to invest in accordance with the guidelines established in each individual fund's prospectus, which allows for investment in non-U.S. securities. Endowment managers are permitted to use derivative instruments to limit foreign currency risk.

As of June 30, 2011 and 2010, the following investments were subject to foreign currency risk (in thousands):

<u>Endowment Investment</u>	<u>Fair Value</u>	
	<u>2011</u>	<u>2010</u>
Common stock	\$ 49,463	
Pooled private equity funds	7,165	\$ 3,896
Total	<u>\$ 56,628</u>	<u>\$ 3,896</u>

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

Notes, loans and accounts receivable as of June 30, 2011 and 2010, respectively follows (in thousands):

	2011		
	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Hospital patient accounts	\$ 116,674	\$ (23,779)	\$ 92,895
Hospital third-party payer settlements	12,310	-	12,310
KMSF patient accounts	22,237	(3,499)	18,738
Dentistry patient accounts	2,488	(731)	1,757
Student loans	25,572	(2,316)	23,256
Reimbursement receivable - grants and contracts	41,954	(638)	41,316
Reimbursement receivable - federal appropriations	1,454	-	1,454
Pledges receivable	49,979	(19,139)	30,840
Accrued interest receivable	2,543	-	2,543
Student receivables	16,329	(7,556)	8,773
Other	22,402	(1)	22,401
<b>Total</b>	<b><u>\$ 313,942</u></b>	<b><u>\$ (57,659)</u></b>	<b><u>\$ 256,283</u></b>
Current portion			\$ 212,179
Noncurrent portion			44,104
<b>Total</b>			<b><u>\$ 256,283</u></b>
	2010		
	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Hospital patient accounts	\$ 124,761	\$ (20,708)	\$ 104,053
Hospital third-party payer settlements	87	-	87
KMSF patient accounts	24,914	(3,311)	21,603
Dentistry patient accounts	2,507	(733)	1,774
Student loans	27,446	(2,380)	25,066
Reimbursement receivable - grants and contracts	48,746	(548)	48,198
Reimbursement receivable - federal appropriations	3,122	-	3,122
Pledges receivable	55,760	(20,456)	35,304
Accrued interest receivable	3,036	-	3,036
Student receivables	13,295	(5,826)	7,469
Other	25,872	-	25,872
<b>Total</b>	<b><u>\$ 329,546</u></b>	<b><u>\$ (53,962)</u></b>	<b><u>\$ 275,584</u></b>
Current portion			\$ 224,138
Noncurrent portion			51,446
<b>Total</b>			<b><u>\$ 275,584</u></b>

#### 4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2011 and capital asset activity for the year ended June 30, 2011 are summarized below (in thousands):

	<u>June 30, 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2011</u>
Land	\$ 63,883	\$ 2,942	\$ 2,149	\$ 64,676
Land improvements - nonexhaustible	24,906	11,310	-	36,216
Land improvements - exhaustible	54,546	4,724	-	59,270
Buildings	1,534,283	461,880	415	1,995,748
Fixed equipment - communications	65,131	9,826	-	74,957
Infrastructure	67,272	20,105	-	87,377
Equipment	472,093	61,053	32,696	500,450
Vehicles	20,955	1,480	1,597	20,838
Library materials	139,245	3,438	4,347	138,336
Nondepreciable library materials	6,536	42	-	6,578
Capitalized software	96,147	7,835	-	103,982
Art	9,531	970	-	10,501
Construction in progress	443,562	44,421	368,311	119,672
	<u>2,998,090</u>	<u>630,026</u>	<u>409,515</u>	<u>3,218,601</u>
<u>Accumulated Depreciation</u>				
Land improvements - exhaustible	47,629	1,512	-	49,141
Buildings	626,409	44,451	52	670,808
Fixed equipment - communications	38,957	3,999	-	42,956
Infrastructure	19,015	3,254	-	22,269
Equipment	319,045	42,984	25,070	336,959
Vehicles	17,575	1,570	1,542	17,603
Library materials	118,653	5,594	-	124,247
Capitalized software	36,952	8,495	-	45,447
	<u>1,224,235</u>	<u>111,859</u>	<u>26,664</u>	<u>1,309,430</u>
Capital assets, net	<u>\$ 1,773,855</u>	<u>\$ 518,167</u>	<u>\$ 382,851</u>	<u>\$ 1,909,171</u>

Capital assets as of June 30, 2010 and capital asset activity for the year ended June 30, 2010 are summarized below (in thousands):

	<u>June 30, 2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2010</u>
Land	\$ 63,436	\$ 447		\$ 63,883
Land improvements - nonexhaustible	21,445	3,461		24,906
Land improvements - exhaustible	53,278	1,268		54,546
Buildings	1,391,014	145,017	\$ 1,748	1,534,283
Fixed equipment - communications	59,935	5,196	-	65,131
Infrastructure	65,775	1,497	-	67,272
Equipment	460,748	42,914	31,569	472,093
Vehicles	20,465	1,366	876	20,955
Library materials	136,084	3,696	535	139,245
Nondepreciable library materials	6,482	54	-	6,536
Capitalized software	89,196	6,951	-	96,147
Art	9,014	517	-	9,531
Construction in progress	340,556	221,571	118,565	443,562
	<u>2,717,428</u>	<u>433,955</u>	<u>153,293</u>	<u>2,998,090</u>
<u>Accumulated Depreciation</u>				
Land improvements - exhaustible	46,351	1,290	12	47,629
Buildings	588,118	38,477	186	626,409
Fixed equipment - communications	34,943	4,014	-	38,957
Infrastructure	16,614	2,401	-	19,015
Equipment	300,097	41,384	22,436	319,045
Vehicles	16,766	1,670	861	17,575
Library materials	114,005	4,648	-	118,653
Capitalized software	29,004	7,948	-	36,952
	<u>1,145,898</u>	<u>101,832</u>	<u>23,495</u>	<u>1,224,235</u>
Capital assets, net	<u>\$ 1,571,530</u>	<u>\$ 332,123</u>	<u>\$ 129,798</u>	<u>\$ 1,773,855</u>

At June 30, 2011, the University had construction projects in progress totaling approximately \$224.8 million in scope. The estimated cost to complete these projects was approximately \$100.6 million. Such construction was principally financed by cash reserves, proceeds from the University's general receipts bonds, capital appropriations and grants from the Commonwealth of Kentucky.

Interest costs incurred during construction, net of related investment income, are capitalized. Total interest capitalized was \$10,146,000 for 2011 and \$12,975,000 for 2010.

During fiscal year 2011, the University utilized capital leases to acquire various items of equipment costing approximately \$11.2 million. Additionally, the University has capital lease agreements to finance renovations to Commonwealth Stadium and the construction of the Wethington Building and the UK Rural Health Center building in Hazard, Kentucky. The University also has utilized capital leases to fund the purchase and implementation of its administrative computing systems and for the lease purchase of land and buildings associated with its purchase of Good Samaritan Hospital. The net book value for capitalized leased land, buildings and equipment is \$139.3 million and \$145.2 million at June 30, 2011 and 2010, respectively.

Non-cash capital asset and related financing activities are summarized below (in thousands):

	<u>2011</u>	<u>2010</u>
Capital lease additions	\$ 8,553	\$ 775
Gifts of capital assets	3,373	3,075
Capital asset additions in accounts payable	28,617	34,302
Capitalized interest, net of investment income	10,146	12,975
Amortized bond discount, premium and cost of issues	386	6
Capital asset disposal, net	11,372	5,621
Capital asset trade in	1,594	957
Total	<u>\$ 64,041</u>	<u>\$ 57,711</u>

## 5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2011 and 2010, respectively, follow (in thousands):

	<u>2011</u>	<u>2010</u>
Payable to vendors and contractors	\$ 98,545	\$ 107,473
Accrued expenses, including vacation and sick leave	62,368	56,164
Employee withholdings and deposits payable to third parties	29,781	30,340
Total	<u>\$ 190,694</u>	<u>\$ 193,977</u>
Current portion	\$ 190,296	\$ 191,318
Noncurrent portion	398	2,659
Total	<u>\$ 190,694</u>	<u>\$ 193,977</u>

## 6. DEFERRED REVENUE

Deferred revenue as of June 30, 2011 and 2010, respectively, follows (in thousands):

	<u>2011</u>	<u>2010</u>
Unearned summer school revenue	\$ 7,409	\$ 6,750
Unearned hospital revenue	6,670	12,710
Unearned grants and contracts revenue	36,282	33,358
Prepaid athletic ticket sales	13,797	14,301
Other	4,467	5,477
Total	<u>\$ 68,625</u>	<u>\$ 72,596</u>
Current portion	\$ 68,625	\$ 66,209
Noncurrent portion	-	6,387
Total	<u>\$ 68,625</u>	<u>\$ 72,596</u>

Noncurrent deferred revenue activity for the years ended June 30, 2011 and 2010 is summarized below (in thousands):

	<u>June 30,</u> <u>2009</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30,</u> <u>2010</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30,</u> <u>2011</u>
Noncurrent deferred revenue	<u>\$ 6,306</u>	<u>\$ 81</u>	<u>\$ -</u>	<u>\$ 6,387</u>	<u>\$ -</u>	<u>\$ 6,387</u>	<u>\$ -</u>

## 7. LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2011 and long-term liability activity for the year ended June 30, 2011 are summarized below (in thousands):

	June 30, 2010	Additions	Reductions	June 30, 2011	Current Portion	Non-Current Portion
<u>Bonds, notes and capital leases</u>						
General receipts notes	\$ 321,050		\$ 12,745	\$ 308,305	\$ 13,775	\$ 294,530
General receipts bonds	160,515	\$ 25,325	2,830	183,010	3,290	179,720
Educational buildings bonds	93,595	-	10,835	82,760	8,545	74,215
Capital leases and other long-term obligations	153,159	13,873	33,140	133,892	29,986	103,906
Notes payable	25,856	600	2,473	23,983	2,105	21,878
Total bonds, notes and capital leases	<u>754,175</u>	<u>39,798</u>	<u>62,023</u>	<u>731,950</u>	<u>57,701</u>	<u>674,249</u>
<u>Other liabilities</u>						
Medical malpractice	31,674	22,314	25,133	28,855	5,353	23,502
Long-term disability	411	-	1	410	410	-
Annuities payable	4,869	343	-	5,212	511	4,701
Health insurance	10,096	34,141	37,786	6,451	6,451	-
Retiree health liability	358	-	358	-	-	-
Automobile and property self insurance	1,088	-	972	116	116	-
Retiree health benefits trust	26,638	21,959	-	48,597	-	48,597
Federal loan programs	21,777	497	849	21,425	-	21,425
Workers compensation	20,400	4,901	4,301	21,000	5,899	15,101
Compensated absences	5,329	1,171	-	6,500	491	6,009
Arbitrage rebate	330	208	536	2	-	2
Unamortized bond premium	9,797	104	632	9,269	631	8,638
Unemployment compensation	507	922	790	639	639	-
Other	642	2,950	642	2,950	-	2,950
Total other liabilities	<u>133,916</u>	<u>89,510</u>	<u>72,000</u>	<u>151,426</u>	<u>20,501</u>	<u>130,925</u>
Total	<u>\$ 888,091</u>	<u>\$ 129,308</u>	<u>\$ 134,023</u>	<u>\$ 883,376</u>	<u>\$ 78,202</u>	<u>\$ 805,174</u>

Long-term liabilities as of June 30, 2010, and long-term liability activity for the year ended June 30, 2010, are summarized as follows (in thousands):

	June 30, 2009	Additions	Reductions	June 30, 2010	Current Portion	Non-Current Portion
<u>Bonds, notes and capital leases</u>						
General receipts notes	\$ 328,450		\$ 7,400	\$ 321,050	\$ 12,745	\$ 308,305
General receipts bonds	62,470	\$ 100,605	2,560	160,515	2,830	157,685
Educational buildings bonds	104,840	-	11,245	93,595	10,835	82,760
Capital leases and other long-term obligations	154,488	26,275	27,604	153,159	28,094	125,065
Notes payable	26,789	-	933	25,856	4,271	21,585
Total bonds, notes and capital leases	<u>677,037</u>	<u>126,880</u>	<u>49,742</u>	<u>754,175</u>	<u>58,775</u>	<u>695,400</u>
<u>Other liabilities</u>						
Medical malpractice	26,781	15,654	10,761	31,674	10,084	21,590
Long-term disability	16	395	-	411	411	-
Annuities payable	4,607	275	13	4,869	465	4,404
Health insurance	10,109	33,192	33,205	10,096	10,096	-
Retiree health liability	-	358	-	358	358	-
Automobile and property self insurance	273	815	-	1,088	1,088	-
Retiree health benefits trust	11,148	15,490	-	26,638	-	26,638
Federal loan programs	22,034	374	631	21,777	-	21,777
Workers compensation	20,000	4,629	4,229	20,400	5,891	14,509
Compensated absences	4,730	599	-	5,329	507	4,822
Supplemental disability	12	-	12	-	-	-
Arbitrage rebate	425	23	118	330	30	300
Unamortized bond premium	10,421	-	624	9,797	624	9,173
Unemployment compensation	270	1,325	1,088	507	507	-
Other	174	468	-	642	-	642
Total other liabilities	<u>111,000</u>	<u>73,597</u>	<u>50,681</u>	<u>133,916</u>	<u>30,061</u>	<u>103,855</u>
Total	<u>\$ 788,037</u>	<u>\$ 200,477</u>	<u>\$ 100,423</u>	<u>\$ 888,091</u>	<u>\$ 88,836</u>	<u>\$ 799,255</u>

Annuities payable consists of the present value of future payments due under charitable remainder annuity trusts, charitable remainder unitrusts, lead trusts, irrevocable trusts and charitable gift annuities, discounted at 7.4 percent.

Bond discounts and premiums are amortized over the life of the bond using a method that approximates the effective interest method.

Bonds payable consist of general receipts bonds, general receipts notes and Consolidated Educational Building Revenue bonds (CEBRB) in the original amount of \$686,120,000 dated June 1, 1998 through November 19, 2010, which bear interest at 0.94 percent to 4.66 percent. The bonds are payable in annual installments through November 1, 2039. The University is required to make semi-annual deposits of varying amounts to the debt service funds held by the trustees. The bonds are secured by the net revenues of the University and the assets restricted under the bond indenture agreements. Capital leases are due in periodic installments through November 20, 2029 and bear interest at 1.73 percent to 7.80 percent.

The indenture agreements require that certain funds be established with the trustee and with the Commonwealth of Kentucky. In addition, CEHRB bonds require a debt service reserve equal to the highest annual aggregate debt service payment due during the remaining lives of the bonds. Currently this amount is \$11,957,000.

On November 19, 2010, \$25,325,000 of University of Kentucky General Receipts Bonds Series 2010 A & B were issued at a net interest cost of 2.21 percent and 0.94 percent respectively. These bonds were issued as Build America Bonds (series A) as authorized under the American Recovery and Reinvestment Act of 2009 and as Qualified Energy Conservation Bonds (series B) as authorized under the Recovery Act and the Hiring Incentives to Restore Employment Act of 2010. The University will receive a cash subsidy from the United States Treasury equal to 35 percent (series A) and 80 percent (series B) of the interest payable on the bonds. This subsidy is recorded in other nonoperating revenues in the Statement of Revenues, Expenses, and Changes in Net Assets.

Principal maturities and interest on bonds, notes and capital leases for the next five fiscal years and in subsequent five-year fiscal periods as of June 30, 2011, are as follows (in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 57,701	\$ 31,480	\$ 89,181
2013	54,331	29,118	83,449
2014	64,410	27,001	91,411
2015	39,753	25,307	65,060
2016	35,197	23,737	58,934
2017-2021	184,298	94,937	279,235
2022-2026	176,450	52,736	229,186
2027-2031	70,515	19,461	89,976
2032-2036	25,345	10,544	35,889
2037-2040	23,950	2,794	26,744
Total	<u>\$ 731,950</u>	<u>\$ 317,115</u>	<u>\$ 1,049,065</u>

At June 30, 2011, assets with a fair market value of approximately \$50,853,000 have been placed on deposit with trustees to totally defease bonds with a par amount of \$48,900,000. The liability for these fully defeased bonds is not included in the financial statements.

## 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, 2011 and June 30, 2010, respectively, restricted expendable net assets were composed of the following (in thousands):

	<u>2011</u>	<u>2010</u>
Appreciation (depreciation) on permanent endowments	\$ 57,949	\$ (14,568)
Term endowments	6,439	5,323
Quasi-endowments initially funded with restricted assets	42,094	35,140
Funds restricted for capital projects and debt service	47,908	59,523
Funds restricted for noncapital purposes	99,149	106,681
Loan funds (primarily University funds required for federal match)	9,885	9,525
Total	<u>\$ 263,424</u>	<u>\$ 201,624</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, 2011 and June 30, 2010, respectively, are as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Working capital requirements	\$ 75,768	\$ 71,181
Budget appropriations for future year fiscal operations	121,379	91,810
Designated for capital projects	26,917	17,291
Designated for renewal and replacement of capital assets	17,730	20,564
Hospital System	269,428	341,004
Affiliated corporations and component units	<u>95,524</u>	<u>72,987</u>
Total	<u>\$ 606,746</u>	<u>\$ 614,837</u>

## 10. PLEDGED REVENUES

Under the University's General Receipts Trust Indenture, substantially all of the unrestricted operating and nonoperating revenues of the University are pledged to secure the payment of debt. For the years ended June 30, 2011 and June 30, 2010, respectively, pledged revenues are as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Student tuition and fees	\$ 223,366	\$ 208,340
Nongovernmental grants and contracts	1,334	1,149
Recoveries of facilities and administrative costs	53,086	50,847
Sales and services	40,051	35,843
Hospital services	794,085	782,677
Auxiliary enterprises - housing and dining	43,263	40,378
Auxiliary enterprises - other	26,789	26,779
Other operating revenue	1,036	1,075
State appropriations	296,472	294,137
Gifts and grants	4,543	3,263
Investment income	<u>4,778</u>	<u>6,724</u>
	<u>\$ 1,488,803</u>	<u>\$ 1,451,212</u>

## 11. INVESTMENT INCOME

Components of investment income (loss) for the years ended June 30, 2011 and June 30, 2010 are as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Interest and dividends earned on endowment investments	\$ 6,159	\$ 15,668
Realized and unrealized gains and losses on endowment investments	135,405	72,243
Interest and dividends on cash and non-endowment investments	5,750	8,907
Realized and unrealized gains and losses on non-endowment investments	(1,058)	(3,190)
Investment income from external trusts	<u>1,684</u>	<u>1,800</u>
Total	<u>\$ 147,940</u>	<u>\$ 95,428</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, 2011 and 2010, the University received income from these trusts of approximately \$1,684,000 and \$1,800,000, respectively. The market value of the external trust assets as of June 30, 2011 and June 30, 2010 was approximately \$52,639,000 and \$46,358,000, 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, 2011, pledges are expected to be collected primarily over the next ten years, as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Operating purposes	\$ 12,588	\$ 16,527
Capital projects	<u>43,108</u>	<u>46,431</u>
Total	55,696	62,958
Less discounts and allowances	<u>(24,856)</u>	<u>(27,654)</u>
Total	<u>\$ 30,840</u>	<u>\$ 35,304</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. For years ended June 30, 2011 and 2010, the University recorded the discounted value of operating and capital pledges using a rate of four percent.

Deferred gifts through insurance, known bequests and irrevocable trusts in which the University has a remainder interest are estimated to be approximately \$103,088,000 at June 30, 2011. The University records these amounts as revenue when the cash is received.

## 14. GRANTS AND CONTRACTS AWARDED

At June 30, 2011, grants and contracts of approximately \$411,309,000 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 five percent and the University contributes ten percent of the participant's eligible compensation to the retirement plan. Participants in group V contribute one percent and the University contributes two percent of the participant's eligible compensation to the retirement plan.

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

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

Under the fully funded University of Kentucky Retirement Plan, the University and plan participants make contributions to provide retirement benefits to employees in individually owned contracts. All payments are vested immediately for employees hired prior to January 1, 2010. For employees hired after January 1, 2010, employer contributions are vested after five years. The University's contributions and costs for 2011 and 2010 were approximately \$75,288,000 and \$76,006,000, respectively. Employees contributed approximately \$37,184,000 in 2011 and \$37,505,000 in 2010. The University's total payroll costs were approximately \$1,046,451,000 and \$985,224,000, respectively, for the years ended June 30, 2011 and 2010. The payroll for employees covered by the retirement plan was approximately \$752,881,000 and \$760,061,000 for the years ended 2011 and 2010, 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. No active employees were eligible for this benefit for the years ended June 30, 2011 and 2010.

The Legislature of the Commonwealth of Kentucky appropriates funds to the University which the University has used for 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. 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. Supplemental retirement benefit payments were approximately \$2,136,000 and \$2,358,000 for the years ended June 30, 2011 and 2010, respectively.

The latest actuarial valuation was prepared as of July 1, 2010, by TIAA CREF. The actuarial present value of accumulated supplemental retirement income benefits as determined by this valuation, utilizing an assumed rate of return of seven percent, was \$10,412,000.

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

The University administers a single-employer defined benefit healthcare plan including medical and prescription drug benefits. The plan provides lifetime healthcare insurance benefits for eligible retirees and their surviving spouses. Employees are eligible for the University retiree health benefits upon retirement after (a) completing 15 years of continuous service and (b) age plus years of service equal at least 75 years ("rule of 75"). Employees hired on or after January 1, 2006 are eligible to participate in the retiree healthcare plan on an "access only" basis upon retirement, but must pay 100 percent of the cost of the selected plan. Employees hired prior to January 1, 2006 are eligible for the University subsidy based on their hire date and surviving spouses receive one-half of the health credit their spouse was entitled to if they were covered by the health plan at the time of the retiree's death. No health credit is provided to a spouse of a living retiree. Human Resources Policies and Procedures define retiree health benefits and can be amended by the President of the University as delegated by the University's Board of Trustees. Employees who were hired before August 1, 1965 are also eligible for \$5,000 of life insurance coverage upon retirement.

The retiree health plan does not issue a publicly available financial report, but is included in this report of the University using the economic resources measurement focus and the accrual basis of accounting under which expenses, including benefits and refunds, are recorded when the liability is incurred. Employer contributions are recorded in the accounting period in which they are earned and become measureable. Investments are reported at fair market value and based on published prices and quotations from major investment brokers at current exchange rates, as available.

The contribution requirements of plan members and the University are established and may be amended by the President of the University. For employees hired before January 1, 2006, the University provides a pre-65 credit of up to 90 percent of the "true retiree" cost of the least expensive pre-65 medical plan. For post-65 benefits, the University provides a credit equal to 90 percent of the "true retiree" cost of the post-65 medical plan. For fiscal year 2011, the University contributed \$24.9 million to the plan. Plan members receiving benefits contributed 25.9 percent of the premium costs, an average for combined single and family coverage. In fiscal year 2011, total member contributions were approximately \$3.5 million.

The University has established a trust fund to segregate plan assets, and currently plans to contribute amounts to the trust fund sufficient to fully fund the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The University will continue to finance retiree benefits by pre-funding benefits and contributing the ARC into a segregated, protected trust fund and will amortize the initial unfunded accrued liability (UAL) over a thirty-year closed period. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The current ARC of \$24.0 million is 4.2 percent of annual covered payroll. There are no long-term contracts for contributions to the plan.

The following table presents the other postemployment benefits (OPEB) cost for the year, the amount contributed and changes in the OPEB Plan for fiscal year 2011 (in thousands):

Annual required contribution	\$ 24,004
Contributions made	<u>(24,866)</u>
Increase in net OPEB obligation/(asset)	(862)
Net OPEB obligation/(asset) - Beginning of year	<u>354</u>
Net OPEB obligation/(asset) - End of year	<u><u>\$ (508)</u></u>

The University's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for fiscal year 2011, 2010 and 2009, were as follows (in thousands):

Fiscal Year Ended	Annual OPEB cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation/(Asset)
6/30/2009	\$ 14,059	102.6%	\$ (362)
6/30/2010	\$ 23,300	96.9%	\$ 354
6/30/2011	\$ 23,999	103.6%	\$ (508)

As of July 1, 2011, the actuarial accrued liability (AAL) for benefits was \$224.0 million, with an actuarial value of assets of \$48.6 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$175.4 million. The covered payroll (annual payroll of active employees covered by the plan) was \$573.9 million and the ratio of the UAAL to the covered payroll was 30.6 percent at June 30, 2011. The University implemented the University of Kentucky Other Postemployment Benefits (OPEB) Trust in July 2007, after the July 1, 2007 actuarial valuation date. As of June 30, 2011, net trust fund assets totaled \$48.6 million.

Actuarial valuation of an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, is designed to present multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The projection of benefits for financial reporting purposes is based on the substantive plan (the plan as understood by the employer and the plan members) and includes the type of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects for legal or contractual funding limitations on the pattern of cost sharing between the employer and plan member in the future. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2010 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included an eight percent discount rate based on the University's funding policy (ARC funding) based on the expected long-term return on the separate trust assets that will be used to finance the payment of plan benefits. The projected annual healthcare trend rate is 8.5 percent for the pre-65 members and 7.75 percent for the post-65 members initially, reduced in decrements to an ultimate rate of five percent after seven years. The expected long-term payroll growth rate was assumed to be three percent per year. The initial UAAL is being amortized as a level percent of pay amount on a closed basis. The remaining amortization period at July 2010 was 27 years.

**18. LONG-TERM DISABILITY BENEFIT PLAN**

The University is self insured for a long-term disability income program and has established a trust for the purpose of paying claims and establishing necessary reserves. Regular employees with a full-time equivalent of .75 or greater who have completed 12 months of service are automatically enrolled in the plan. To be covered, an employee must be actively at work on the first day of the month after the employee completes one full year of service. An employee approved for long-term disability receives benefits based on the employee's basic regular monthly salary at the time of the onset of the disabling condition. Primary income benefits provide payment of 60 percent of the basic regular monthly salary less any disability received from government programs and/or another employer for the same condition. Basic salary for medical faculty is defined as the tenure base salary. Other sources of income used in the benefit formula include Social Security, worker's compensation or other similar government programs, veterans' or other governmental disability payments, or other employer-sponsored disability benefits.

Employees approved for long-term disability receive 100 percent of their basic salary for the first six months and 60 percent thereafter. Benefits end when members recover, die, terminate employment or retire. In most cases, claimants retire at age 65. The plan also includes provisions for health insurance that allow participants who were enrolled in a health plan at the time their disability benefit began to continue health coverage (University subsidy limited to 29 months for claimants approved on or after October 1, 2006), life insurance benefit (\$10,000 before July 1, 2007 or one times salary on or after July 1, 2007) and retirement contributions equal to ten percent of pre-disability salary per year for applications filed on or after October 1, 2006 and 15 percent of pre-disability salary per year for applications filed before October 1, 2006.

The long-term disability plan does not issue a publicly available financial report, but is included in this report of the University using the economic resources measurement focus and the accrual basis of accounting under which expenses, including benefits and refunds, are recorded when the liability is incurred. Employer contributions are recorded in the accounting period in which they are earned and become measurable. Investments are reported at fair market value and based on published prices and quotations from major investment brokers at current exchange rates, as available. The coverage of the long-term disability benefits is established and may be amended by the President of the University.

The University currently plans to contribute amounts to the trust fund sufficient to fully fund the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The University will continue to finance long-term disabilities by pre-funding benefits and contributing to the ARC into a segregated, protected trust fund and will amortize the initial unfunded accrued liability (UAL) over a thirty year closed period. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC of \$2.8 million is 0.6 percent of annual covered payroll. There are no long-term contracts for contributions to the plan. The following table presents the OPEB cost for the year, the amount contributed and changes in the OPEB plan for fiscal year 2011 (in thousands):

Annual required contribution	\$ 2,844
Contributions made	<u>(2,834)</u>
Increase in net OPEB obligation/(asset)	10
Net OPEB obligation/(asset) - Beginning of year	<u>400</u>
Net OPEB obligation/(asset) - End of year	<u><u>\$ 410</u></u>

The University's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for fiscal year 2011, 2010 and 2009 were as follows (in thousands):

Fiscal Year Ended	Annual OPEB cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation/(Asset)
6/30/2009	\$ 2,238	99.7%	\$ 7
6/30/2010	\$ 2,759	85.8%	\$ 400
6/30/2011	\$ 2,842	99.7%	\$ 410

As of July 1, 2011, the actuarial accrued liability (AAL) for benefits was \$19.9 million and the actuarial value of assets was \$11.1 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$8.8 million. The covered payroll (annual payroll of active employees covered by the plan) was \$452.0 million and the ratio of the UAAL to the covered payroll was two percent at June 30, 2011.

Actuarial valuation of an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of events far into the future. Major factors affecting all long-term disability benefits are the rate at which people become disabled and how quickly they are expected to recover from disability. These rates will improve or deteriorate over time, for example with the state of the economy, with technological development and health related events. Other factors that could also impact the liability include salary inflation, changes in utilization patterns, changes to government programs and technological advances, such as new drugs or equipment. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, is designed to present multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The projection of benefits for financial reporting purposes is based on the substantive plan (the plan as understood by the employer and the plan members) and includes the type of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2010 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included an eight percent discount rate based on the University's funding policy (ARC funding) based on the expected long-term return on the separate trust assets that will be used to finance the payment of plan benefits. The projected elimination period is six months; termination (mortality and recovery from disability) and gender and age-related disability incidence rates are based on the 1987 Commissioner's Group Long Term Disability Table. Payments are assumed to be made until the later of (a) age 65 or (b) five years after date of disability. The projected long-term income benefit is based on actual net benefit currently being paid with social security offset. For people who have been disabled for less than 24 months and are currently not entitled to a social security offset, it was assumed that the offset will eventually be approved according to the following table:

Months Since Disability	Proportion
<12	5%
12-17	40%
18-23	40%
24+	80%

The future salary increase for active members was assumed to be three percent per year. The UAAL is being amortized as a level percent of pay amount on a closed basis. The remaining amortization period at July 1, 2010 was 27 years.

## **19. 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 \$1.00 billion per occurrence with buildings insured 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 2010 to 2011. 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. An actuarial valuation is performed to determine the self insurance funding requirements and the fund liability, which has been discounted using an interest rate of six percent. The malpractice liability as of June 30, 2010 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 loss 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, 2011.

The University also self-insures certain employee benefits, including health insurance, worker's compensation and unemployment claims to the extent not covered by insurance. The University has recorded an estimate for asserted claims at June 30, 2011.

## **20. 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.

## **21. 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 RCTF, 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.

With the passage of the 2008-2010 budget of the Commonwealth, the 2008 General Assembly authorized \$50 million in General Fund supported bonds in 2008-2009 for the Research Challenge Trust Fund (RCTF) to support the Endowment Match Program and a newly created Research Capital Match Program. In accordance with KRS 164.7917, these funds will be allocated two-thirds to the University of Kentucky (\$33.3 million) and one-third to the University of Louisville (\$16.7 million). At its June 9, 2009 Board Meeting, the University of Kentucky Board of Trustees approved the allocation of UK's Research Challenge Trust Fund appropriation as follows: \$21,927,000 to the Research Capital Match Program and \$11,406,000 to the Endowment Match Program.



The status of the RCTF endowed funds as of June 30, 2011, is summarized as follows (in thousands):

	Kentucky General Assembly Funding	University of Kentucky Share of Funding	State Funds Received to Date	Matching Pledges Receivable
1998 Biennium	\$ 100,000	\$ 66,667	\$ 66,667	
2000 Biennium	100,000	68,857	68,857	
2002 Biennium	100,000	66,667	66,667	\$ 7,110
2008 Biennium: Capital Projects	21,927	21,927	21,927	6,194
2008 Biennium: RCTF	<u>28,073</u>	<u>11,406</u>	<u>11,401</u>	<u>2,164</u>
Total	<u>\$ 350,000</u>	<u>\$ 235,524</u>	<u>\$ 235,519</u>	<u>\$ 15,468</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 Endowment Match Program funds totaling \$5,300 have been submitted and are outstanding as of June 30, 2011.

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. Endowment pledges are not recognized as revenue until the gifts are received.

A payment schedule of the outstanding pledges is shown below (in thousands):

	2002 Biennium	2008 Biennium: Capital Projects	2008 Biennium: RCTF
Pledges due in fiscal year 2011 or prior	\$ 1,006	\$ 234	\$ 291
Pledges due in fiscal year 2012	6,054	2,160	502
Pledges due in fiscal year 2013	50	2,155	731
Pledges due in fiscal year 2014	-	1,645	608
Pledges due in fiscal year 2015	-	-	32
Total	<u>\$ 7,110</u>	<u>\$ 6,194</u>	<u>\$ 2,164</u>

## 22. 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, 2011 and June 30, 2010, respectively, follows (in thousands):

	2011	2010
Funds from private sources approved for match	\$ 1,835	\$ 1,756
Cigarette excise tax funds distributed	<u>2,172</u>	<u>2,573</u>
Total cancer research matching fund revenues	<u>\$ 4,007</u>	<u>\$ 4,329</u>
Cancer research matching fund expenses	<u>\$ 12,806</u>	<u>\$ 11,895</u>

## 23. NATURAL CLASSIFICATION

The University's operating expenses by natural classification were as follows for the years ended June 30, 2011 and June 30, 2010, respectively (in thousands):

	2011	2010
Salaries and wages	\$ 1,057,806	\$ 994,491
Employee benefits	323,792	308,178
Supplies and services	536,700	528,906
Depreciation	111,859	101,832
Student scholarships and financial aid	45,088	41,877
Purchased utilities	49,524	47,011
Other, various	71,885	92,685
Total	<u>\$ 2,196,654</u>	<u>\$ 2,114,980</u>

## 24. CURRENT ECONOMIC CONDITIONS

The current protracted economic decline continues to present the University with difficult circumstances and challenges, which in some cases has left an uncertain future for public and federal support for higher education. The financial statements have been prepared using values and information currently available to the University.

The 2008 recession has made it challenging for many donors to continue to contribute to not-for-profit organizations. The last fiscal year has seen a strong return on the fair value of investments as well as contribution revenue, which has positively impacted the University's operating position. However, the recession left a deep chasm in the global marketplace and the unprecedented growth that existed prior to the recession is unlikely to return for the foreseeable future. As the Commonwealth continues to manage the impact of the recession on the global economy, public support for higher education and federal support for research remains uncertain. The University of Kentucky must meet the demands of the apparent paradigm shift in higher education finance. A significant decline in the fair value of investments, as well as contribution revenue could have an adverse impact on the University's future operating results.

On March 23, 2010, President Obama signed into law the healthcare reform bill, the Patient Protection and Affordable Care Act (PPACA). This legislation plus the Health Care and Education Reconciliation Act of 2010, makes sweeping changes to the US health care system. The actual implementation of these Acts will happen over many years but UK Healthcare will begin to see the impact of the potential changes in the near future. The majority of the measures are designed to change the care delivery system but it also includes changes to insurance markets and pricing transparency.

In addition, the rising unemployment rate has made it difficult for certain patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on UK Healthcare's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the continued volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values; allowances for contribution and patient receivables; and the valuation of intangibles that could negatively impact the University's ability to meet debt covenants or maintain sufficient liquidity. Due to the volatility of capital markets subsequent to year end, changes in investment values have been significant and may continue to affect investment amounts in the statement of net assets in the near term.

**UNIVERSITY OF KENTUCKY**  
**A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY**  
**REQUIRED SUPPLEMENTARY INFORMATION**

**1. HEALTH INSURANCE BENEFITS FOR RETIREES**

The University of Kentucky's (the University) Other Postemployment Benefit Plan (OPEB Plan) is administered through the University's OPEB Trust Fund as an irrevocable trust. Assets of the trust fund are dedicated to providing post-retirement health insurance coverage to current and eligible future university retirees. Only employees hired prior to January 1, 2006 are eligible to receive post-retirement health insurance benefits.

The following schedules present the University's actuarially determined funding progress and required contributions for the University's Other Postemployment Benefits Trust using the projected unit credit actuarial cost method:

Schedule of Funding Progress by Valuation Date  
(In thousands)

Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
July 1, 2008	\$ 7,251	\$ 141,171	\$ 133,920	5.1%	\$ 614,928	21.8%
July 1, 2009	\$ 11,148	\$ 235,966	\$ 224,818	4.7%	\$ 590,446	38.1%
July 1, 2010	\$ 26,638	\$ 253,318	\$ 226,680	10.5%	\$ 562,887	40.3%
July 1, 2011	\$ 48,597	\$ 223,971	\$ 175,374	21.7%	\$ 573,894	30.6%

Schedule of Employer Contributions  
(In thousands)

Year Ended	Annual Required Contributions	Percentage Contributed
June 30, 2008	\$ 13,649	100.0%
June 30, 2009	\$ 14,059	102.6%
June 30, 2010	\$ 23,305	96.9%
June 30, 2011	\$ 24,004	103.6%

**2. LONG-TERM DISABILITY BENEFIT PLAN**

The University is self insured for a long-term disability income program and has established a trust for the purpose of paying claims and establishing necessary reserves. Regular employees with a full-time equivalent of .75 or greater who have completed 12 months of service are automatically enrolled in the plan.

The following schedules present the University's actuarially determined funding progress and required contributions for the University's long-term disability benefit trust fund using the projected unit credit actuarial cost method:

Schedule of Funding Progress by Valuation Date  
(In thousands)

Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
July 1, 2008	\$ 7,601	\$ 21,583	\$ 13,982	35.2%	\$ 444,981	3.1%
July 1, 2009	\$ 6,551	\$ 23,552	\$ 17,001	27.8%	\$ 473,835	3.6%
July 1, 2010	\$ 8,132	\$ 24,838	\$ 16,706	32.7%	\$ 453,429	3.7%
July 1, 2011	\$ 11,112	\$ 19,909	\$ 8,797	55.8%	\$ 451,970	2.0%

Schedule of Employer Contributions  
(In thousands)

Year Ended	Annual Required Contributions	Percentage Contributed
June 30, 2008	\$ 2,208	100.0%
June 30, 2009	\$ 2,240	99.7%
June 30, 2010	\$ 2,761	85.7%
June 30, 2011	\$ 2,844	99.7%

UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
STATEMENT OF NET ASSETS SCHEDULE  
JUNE 30, 2011  
(in thousands)

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Athletic Association	Humanities Foundation	Mining Engineering Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
<b>ASSETS</b>											
<b>Current Assets</b>											
Cash and cash equivalents	\$ 227,971	\$ 37,663	\$ 10,741		\$ 22,778	\$ 17	\$ 16	\$ 54	\$ 507	\$ 3,091	\$ 302,838
Notes, loans and accounts receivable, net	145,852	42,444	2,297	\$ 15	306					21,265	212,179
Investments										10,989	10,989
Inventories and other	26,216	3,951			3,825				12	52	34,056
Total current assets	400,039	84,058	13,038	15	26,909	17	16	54	519	35,397	560,062
<b>Noncurrent Assets</b>											
Restricted cash and cash equivalents	76,906						42				76,948
Endowment investments	936,906	3,928	208	7,983	289	1,266	1,668				952,248
Other long-term investments	175,433	1,803								35,356	212,592
Notes, loans and accounts receivable, net	43,041			27						1,036	44,104
Other noncurrent assets	15,434	3,956								341	19,731
Capital assets, net	1,854,752	14,479			1,811				275	37,854	1,909,171
Total noncurrent assets	3,102,472	24,166	208	8,010	2,100	1,266	1,710	-	275	74,587	3,214,794
Total assets	3,502,511	108,224	13,246	8,025	29,009	1,283	1,726	54	794	109,984	3,774,856
<b>LIABILITIES</b>											
<b>Current Liabilities</b>											
Accounts payable and accrued liabilities	166,723	16,814	535		2,092		2		519	3,611	190,296
Deferred revenue	15,642	39,124	62		13,797						68,625
Long-term liabilities - current portion	74,253	695	771							2,483	78,202
Total current liabilities	256,618	56,633	1,368	-	15,889	-	2	-	519	6,094	337,123
<b>Noncurrent Liabilities</b>											
Accounts payable and accrued liabilities	398										398
Long-term liabilities	782,475	4,197			872					17,630	805,174
Total noncurrent liabilities	782,873	4,197	-	-	872	-	-	-	-	17,630	805,572
Total liabilities	1,039,491	60,830	1,368	-	16,761	-	2	-	519	23,724	1,142,695
<b>INTERFUND BALANCES</b>	25,725	(3,788)			(106)					(21,831)	-
<b>NET ASSETS</b>											
<b>Invested in capital assets, net of related debt</b>	1,188,253	12,609			1,810				275	15,557	1,218,504
<b>Restricted</b>											
Nonexpendable	536,832	752	30	4,607		616	650				543,487
Expendable	253,605	3,647	621	3,418	338	667	1,074	54			263,424
Total restricted	790,437	4,399	651	8,025	338	1,283	1,724	54	-	-	806,911
<b>Unrestricted</b>											
Total net assets	\$ 2,488,745	\$ 43,606	\$ 11,878	\$ 8,025	\$ 12,142	\$ 1,283	\$ 1,724	\$ 54	\$ 275	\$ 64,429	\$ 2,632,161

UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS SCHEDULE  
FOR THE YEAR ENDED JUNE 30, 2011  
(in thousands)

49

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Athletic Association	Humanities Foundation	Mining Engineering Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
<b>OPERATING REVENUES</b>											
Student tuition and fees, net	\$ 223,366										\$ 223,366
Federal grants and contracts	2,072	\$ 184,235									186,307
State and local grants and contracts	67,714	68,954	\$ 1,421								138,089
Nongovernmental grants and contracts	(3,006)	26,717	4,343								28,054
Recoveries of facilities and administrative costs	277	52,809									53,086
Sales and services	25,742	6,780	12,943					\$ 21	\$ 7,159		52,645
Federal appropriations	16,606										16,606
County appropriations	18,217										18,217
Professional clinical service fees										\$ 202,767	202,767
Hospital services	794,085										794,085
Auxiliary enterprises:											
Housing and Dining, net	43,263										43,263
Athletics					\$ 66,527						66,527
Other auxiliaries	26,789										26,789
Other operating revenues	1,037									890	1,927
Total operating revenues	1,216,162	339,495	18,707	-	66,527	-	-	21	7,159	203,657	1,851,728
<b>OPERATING EXPENSES</b>											
Educational and general:											
Instruction	250,221	15,243	504				\$ 63				266,031
Research	85,955	185,032	275	\$ 30							271,292
Public service	154,640	119,247	1,096								274,983
Libraries	19,913		4								19,917
Academic support	74,145	3,298	3,715								81,158
Student services	30,798	28	153			\$ 1					30,980
Institutional support	46,901	874	291					62	7,103		55,231
Operations and maintenance of plant	65,518	83									65,601
Student financial aid	25,925	1,245	1,529			38					28,737
Depreciation	68,594	1,126							82		69,802
Total educational and general	822,610	326,176	7,567	30	-	39	63	62	7,185	-	1,163,732
Clinical operations (including depreciation of \$2,412)										146,276	146,276
Hospital (including depreciation of \$35,500)	757,282		50								757,332
Auxiliary enterprises:											
Housing and dining (including depreciation of \$3,612)	43,777										43,777
Athletics (including depreciation of \$533)	(390)				66,376						65,986
Other auxiliaries	18,884										18,884
Other expenses	667										667
Total operating expenses	1,642,830	326,176	7,617	30	66,376	39	63	62	7,185	146,276	2,196,654
Net income (loss) from operations	(426,668)	13,319	11,090	(30)	151	(39)	(63)	(41)	(26)	57,381	(344,926)
<b>NONOPERATING REVENUES (EXPENSES)</b>											
State appropriations	296,472										296,472
State fiscal stabilization fund	17,224										17,224
Gifts and grants	87,822	81	325	93				75			88,396
Investment income (loss)	145,315	671	45	1,273	71	196	280		1	88	147,940
Interest on capital asset-related debt	(20,842)	(158)								(1,550)	(22,550)
Grant to/(from) the University for non-capital purposes	50,586	(6,371)	(11,207)	(736)	11,286	(4)	(6)	(81)		(43,467)	-
Other nonoperating revenues and expenses, net	3,048	1,971			2,133						7,152
Net nonoperating revenues (expenses)	579,625	(3,806)	(10,837)	630	13,490	192	274	(6)	1	(44,929)	534,634
Net income (loss) before other revenues, expenses, gains, or losses	152,957	9,513	253	600	13,641	153	211	(47)	(25)	12,452	189,708
Capital appropriations	12,477										12,477
Capital grants and gifts	13,577	15,850			30					(120)	29,337
Additions to permanent endowments	16,337	1									16,338
Grant to/(from) the University for capital purposes	30,405	(15,100)	(279)		(15,026)						-
Other, net	(5,538)				72					(210)	(5,676)
Total other revenues	67,258	751	(279)	-	(14,924)	-	-	-	-	(330)	52,476
<b>INCREASE (DECREASE) IN NET ASSETS</b>	220,215	10,264	(26)	600	(1,283)	153	211	(47)	(25)	12,122	242,184
<b>NET ASSETS, beginning of year</b>	2,268,530	33,342	11,904	7,425	13,425	1,130	1,513	101	300	52,307	2,389,977
<b>NET ASSETS, end of year</b>	\$ 2,488,745	\$ 43,606	\$ 11,878	\$ 8,025	\$ 12,142	\$ 1,283	\$ 1,724	\$ 54	\$ 275	\$ 64,429	\$ 2,632,161

**University of Kentucky**  
**Governing Board as of June 30, 2011**

**Officers of the Board**

Edward Britt Brockman, Chair  
James W. Stuckert, Vice Chair  
Pamela T. May, Secretary

**Board of Trustees**

Sheila Brothers  
Penelope A. Brown  
Jo Hern Curriss  
Dermontti F. Dawson  
William Stamps Farish, Jr.  
Oliver Keith Gannon  
Carol Martin "Bill" Gatton  
Everett McCorvey  
Billy Joe Miles  
Terry Mobley  
Sandy Bugie Patterson  
Joe Peek  
Erwin Roberts  
Charles R. Sachatello  
C. Frank Shoop  
Ryan M. Smith  
Barbara Young

**Administrative Staff as of July 1, 2011**

**Executive Officers**

Eli Capilouto, President  
Kumble R. Subbaswamy, Provost  
Frank Butler, Executive Vice President  
for Finance and Administration  
Michael Karpf, Executive Vice President for  
Health Affairs

**Administrative Officers**

Mike Adams, Chair, Staff Senate  
Heidi Anderson, Interim Vice President for  
Institutional Research, Planning, and  
Effectiveness  
Mitchell S. Barnhart, Director of Athletics  
Ronda S. Beck, Controller  
Thomas W. Harris, Vice President for University  
Relations  
Leonard E. Heller, Vice President for  
Commercialization and Economic  
Development  
Judy "J.J." Jackson, Vice President for  
Institutional Diversity  
Barbara W. Jones, General Counsel  
Angela Martin, Vice President for Financial  
Operations and Treasurer  
D. Michael Richey, Vice President for  
Development  
Hollie Swanson, Chair, University Senate  
Council  
Bill Swinford, Chief of Staff

**Academic Officers**

M. Scott Smith, Dean  
College of Agriculture  
Mark Kornbluh, Dean  
College of Arts and Sciences  
Merle Hackbart, Acting Dean  
College of Business and Economics  
Dan O'Hair, Dean  
College of Communications  
Sharon P. Turner, Dean  
College of Dentistry  
Michael Speaks, Dean  
College of Design  
Mary John O'Hair, Dean  
College of Education  
Thomas W. Lester, Dean  
College of Engineering  
Michael S. Tick, Dean  
College of Fine Arts  
Jeannine Blackwell, Dean  
Graduate School  
Lori Gonzalez, Dean  
College of Health Sciences  
David A. Brennan, Dean  
College of Law  
Terry Birdwhistell, Dean  
Libraries  
Frederick C. de Beer, Dean  
College of Medicine  
Jane M. Kirschling, Dean  
College of Nursing  
Timothy S. Tracy, Dean  
College of Pharmacy  
Stephen Wyatt, Dean  
College of Public Health  
James P. "Ike" Adams, Jr., Dean  
College of Social Work



see blue.™



**UK**<sup>®</sup>  
UNIVERSITY OF  
KENTUCKY<sup>®</sup>

The University of Kentucky is committed to a policy of providing opportunities to people regardless of economic or social status and will not discriminate on the basis of race, color, ethnic origin, creed, religion, political belief, sex, sexual orientation, marital status, age veteran status, or physical or mental disability.

The University of Kentucky is an Equal Opportunity University. Questions concerning compliance with regulations may be directed to the Equal Opportunity Office, 13 Main Building, University of Kentucky, Lexington, KY 40506-0032. (859) 257-827 or at [www.uky.edu/evpfa/eo](http://www.uky.edu/evpfa/eo)

[www.uky.edu](http://www.uky.edu)