2012 Financial Statements

UK

UNIVERSITY OF
KENTUCKY

University of Kentucky
A Component Unit of the Commonwealth of Kentucky
Financial Statements
Years Ended June 30, 2012 and 2011

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MESSAGE FROM THE PRESIDENT

For nearly 150 years, the University of Kentucky has been committed to our founding covenant - the Kentucky Promise – which has guided our work of preparing students for lives of leadership, meaning and purpose; conducting groundbreaking research that advances science and discovery; and rendering dedicated service and life-saving patient care to the people of the Commonwealth**.**

This Promise - birthed in the midst of our country's darkest hours - has endured devastating global conflict, survived entrenched financial turmoil and adapted to the ever-changing world of higher education.

Today, our Promise is increasingly essential as economies, countries and industries manage seismic shifts and the globe grows more interdependent. The presence of a well-educated, world-ready workforce is no longer the luxury of industrialized nations; it is an imperative for all countries – developed and developing – to prosper. It is within that framework that colleges and universities can, must and will lead as engines of prosperity - fundamental mechanisms of opportunity - benefiting the community, state and nation they serve.

To meet the call, the University of Kentucky has prepared an innovative blueprint - guided by the principles and goals of our 2009-2014 Strategic Plan and an ambitious statewide mandate to be one of the nation's premier research universities - that will position our institution to light the path toward a better future for the Commonwealth. Our course emphasizes the core priorities of education, research and service while encouraging creativity and maintaining quality and access.

We have made great strides because of the long-standing commitment of our devoted faculty and staff, the people who have inspired progress, sought knowledge and mentored young minds over the last century-and-a-half. We have begun seeing positive signs during the last fiscal year:

- At 28,094 students, UK broke its enrollment record for the second year in a row; and research and professional practice doctoral enrollment reached a new high of 4,234.
- The mean ACT Composite for the Fall 2011 first-year class increased to 25.4, and included 394 students from the Governor’s School for the Arts/Governor’s Scholars Program and 32 National Merit Scholars.
- In Fall 2011, minority and international student enrollment accounted for 17 percent of the total headcount with a record 1,499 African American students and 412 international undergraduate students.
- At 81.5 percent, UK achieved a first-to-second year retention rate greater than 80 percent for the fourth year in a row – an increase of almost five percent in recent years.
- In 2011-2012, UK awarded 5,853 degrees, including 888 research and professional doctorates.
- The University's new general education curriculum - UK Core - was fully

implemented and launched in Fall 2011. The Core is designed to prepare world-ready graduates with academic components in the arts, communications, quantitative reasoning and cultural immersion.
- UK completed a strong year in philanthropy, securing $105.4 million in gifts and pledges from nearly 53,000 donors—an 8.1% increase in total gifts and pledges and a ten percent increase in our donor base.

Our achievement going forward – built on a foundation of financial responsibility and public accountability – will be undergirded by our ability to think imaginatively as we execute endeavors that support our core mission and values. Already, we have demonstrated innovation and determination in our ongoing effort:

UK began laying the groundwork for a new approach to our budgeting processes. We are creating a financial model of accountability that will allow deans and administrative leadership to implement long-term plans that will move their units forward. The goal is to encourage an entrepreneurial spirit that will empower decision-makers on the front lines with the tools necessary to act in the best interests of their units and core functions.

The University of Kentucky entered into a public/private partnership with Education Realty Trust (EdR) – the first of its kind in the nation – to initiate the renewal and construction of some 9,000 beds on our campus by 2018. EdR has put forward a 100 percent equity stake in this project, allowing UK to reserve university funds as part of a capital investment pool to rebuild our learning and research spaces.

Our investment in a modern campus environment - one that stimulates collaboration and creativity – will complement the benefits of direct student support, growth of quality academic programs, and efforts to expand access and ensure affordability.

Between 2008 and 2011, our instructional faculty ranks grew by more than nine percent, yielding an appropriately sized cadre of exceptional teachers and researchers to successfully educate more students. Now, we must ensure that they - and our staff - are paid competitively. We are creating a five percent merit raise pool in 2013-2014 to reward our top-talent, thereby ensuring a quality experience for our students, patients and community partners. Growth in our scholarship offerings will award and support the academic development of our best and brightest. UK is investing $10.3 million more in the coming year to maintain our current commitments and expand scholarships and financial aid to students. And we plan to hold tuition increases to three percent in 2013-14, a decision that signals our commitment to affordability.

By enhancing academic programs such as the Honors Program, we are better able to meet the needs of our top scholars. Close-knit learning environments allow for an opportunity to work alongside world-class faculty with the resources of a modern research university.

Going forward, we will continue to focus on our priorities and shared values. The University is putting forth considerable effort to restructure our operations and processes, so that we are prepared to lead as the Commonwealth's engine for growth through our three-fold mission of education, research and service.

These are times of opportunity for higher education. Colleges and universities are the economic engines of our country, the foundation of prosperity in our community and the greatest asset for long-term global competitiveness. Because of the lives we touch, the improved general welfare of our society and the betterment of our way of life, we will not step back from our obligation as the Commonwealth's flagship, land grant and research university.

We can, we must and we will honor the Kentucky Promise for another generation.

Eli Capilouto
President

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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, 2012 and 2011, 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), a blended component unit of the University, which statements reflect total assets of $118,480,156 and $110,370,427 as of June 30, 2012 and 2011, respectively, and total revenues of $228,361,590 and $210,443,090, respectively, for the years then ended. Those statements were audited by other accountants whose report 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 audit 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 provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports 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, 2012 and 2011, 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 28, 2012, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and post-employment pension information, as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information, the statement of net assets schedule and statement of revenues, expenses and changes in net assets schedule and governing board and administrative staff listing, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, based on our audit and the report of other accountants, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Our audit was performed for the purpose of forming an opinion on the basic financial statements as a whole. The board of directors listing and the message from the President as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

BKD, LLP

September 28, 2012

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, 2012 and June 30, 2011. 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 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:

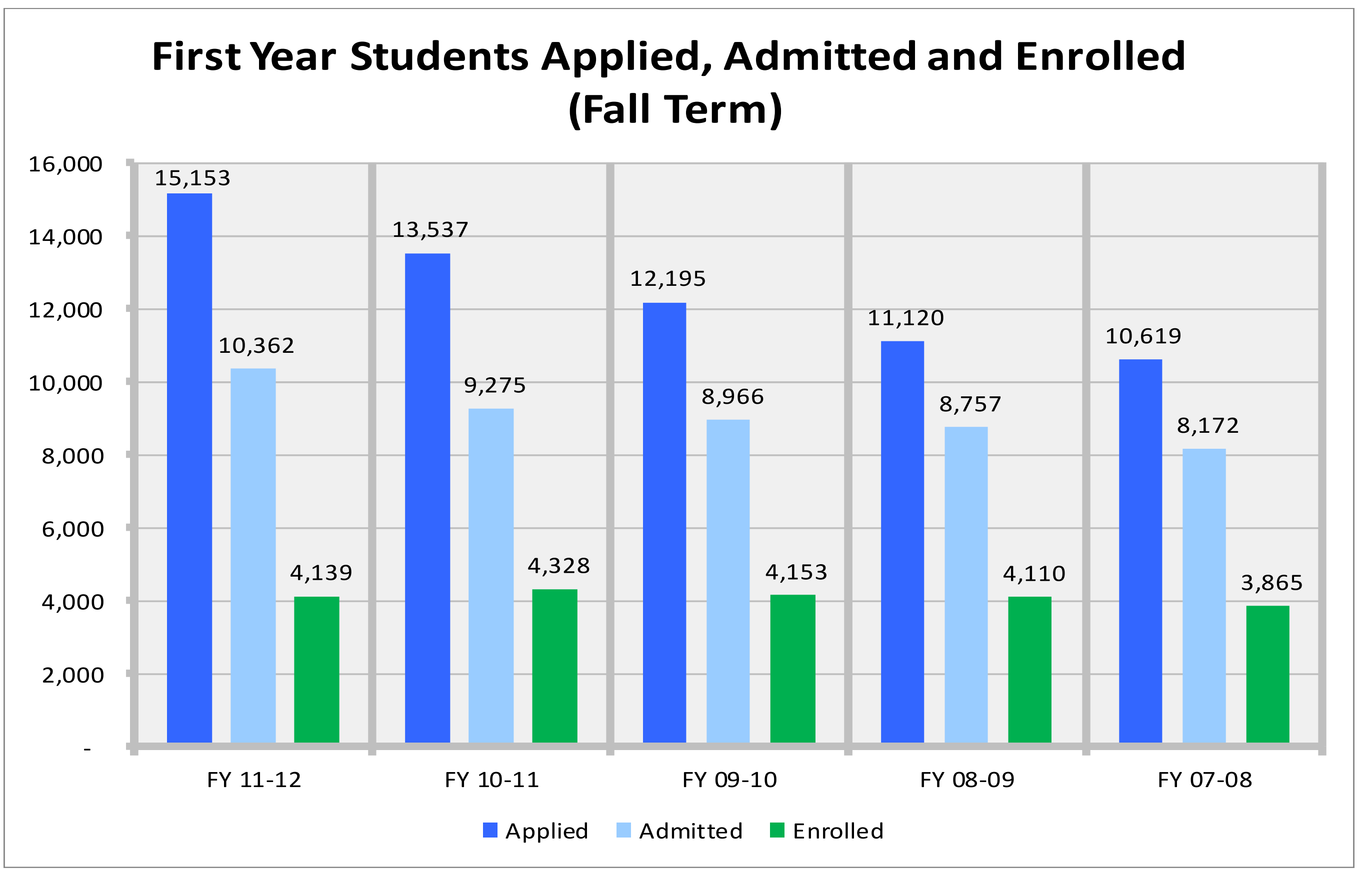
- Prepare Students for Leading Roles in an Innovation-driven Economy and Global Society
- Promote Research and Creative Work to Increase the Intellectual, Social, and Economic Capital of Kentucky and the World Beyond Its Borders
- Develop the Human and Physical Resources of the University to Achieve 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). For nearly 150 years, we have been a beacon for Kentucky, shining bright a path to prosperity and economic competitiveness. We remain steadfast in our covenant with the Commonwealth – our Kentucky Promise – to produce graduates prepared for a 21st century economy; to conduct research that extends the boundaries of scientific discovery; and to render service and patient care that uplifts 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).

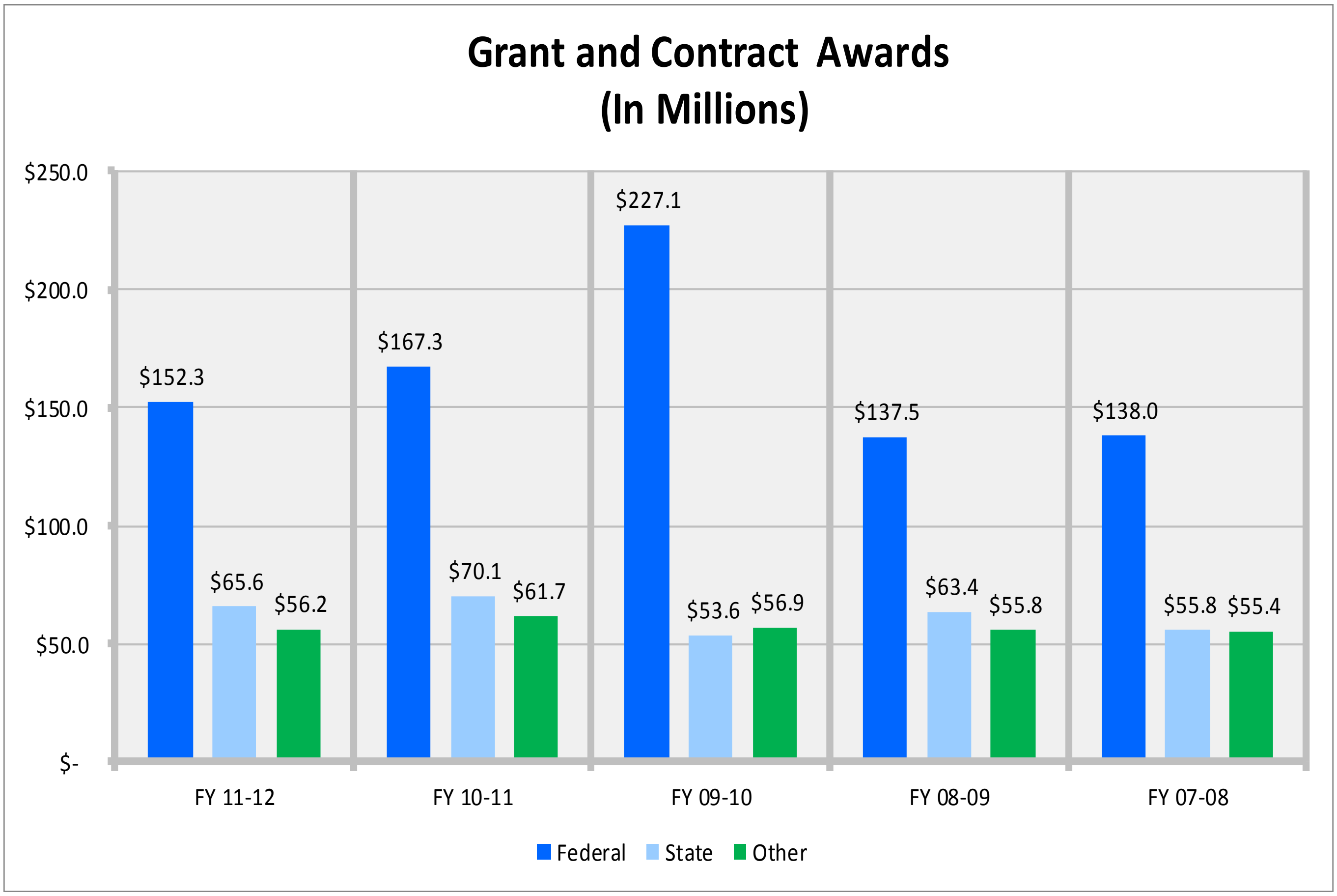
The University is accredited by the Commission on Colleges (CoC) of the Southern Association of Colleges and Schools (SACS). This has been re-affirmed at approximately 10-year intervals since 1915, with the next accreditation review scheduled to begin in 2012. In addition, several degree programs and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

Students. In Fall 2011, the University of Kentucky had 28,094 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 3,300 students (13 percent) since Fall 2002.



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 $373.0 million for fiscal year 2010-11, compared to $360.0 million in 2009-10. Research awards received during fiscal year 2011-12 total $274.1 million, an eight 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 560.42 beds. On a monthly basis, the hospitals provide approximately: 1,100 inpatient surgeries, 1,200 outpatient surgeries, 28,300 radiology procedures, 29,900 outpatient services, 7,500 emergency department visits and 46,500 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. Ongoing Medical Campus construction continues in the Patient Care Facility with the addition of eight state-of-the-art operating rooms in January 2012 and a new data center in July 2012. These additions will provide unparalleled service to patients, staff and visitors of UK HealthCare.

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 $3.76 billion and liabilities of $1.08 billion as of June 30, 2012. Net assets, which represent the University's residual interest in assets after liabilities are deducted, were $2.68 billion (71 percent of total assets.)

- Total assets decreased a $16.6 million (less than one percent), primarily due to decreases in other long-term investments and cash and cash equivalents, offset by increases in net capital assets and accounts receivable.

- Total liabilities decreased $60.8 million (five percent), primarily due to the payments of current year principal maturities on bonds and capital lease obligations and decreases in accounts payable and accrued liabilities.

- Total net assets increased $44.2 million (two percent) from June 30, 2011 to June 30, 2012. Invested in capital assets, net of depreciation and related debt, increased $80.7 million offset by a decrease in unrestricted net assets of $29.5 million, and a decrease in restricted net assets of $7.0 million largely due to investment losses on endowments.

- Operating revenues were $1.98 billion and operating expenses were $2.35 billion, resulting in a loss from operations of $364.7 million. Nonoperating and other revenues, net of nonoperating expenses, were $408.9 million, including $297.6 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, 2012, with comparative information as of June 30, 2011. 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, 2012; June 30, 2011; and June 30, 2010 follows:

Condensed Statements of Net Assets (in thousands)

	2012	2011	2010
ASSETS			
Current assets	$ 578,460	$ 560,062	$ 712,530
Capital assets, net of depreciation	1,974,953	1,909,171	1,773,855
Other noncurrent assets	1,204,885	1,305,623	1,058,256
Total Assets	3,758,298	3,774,856	3,544,641
LIABILITIES			
Current liabilities	316,440	337,123	346,363
Noncurrent liabilities	765,471	805,572	808,301
Total Liabilities	1,081,911	1,142,695	1,154,664
NET ASSETS			
Invested in capital assets, net of related debt	1,299,249	1,218,504	1,047,225
Restricted			
Nonexpendable	557,712	543,487	526,291
Expendable	242,157	263,424	201,624
Unrestricted	577,269	606,746	614,837
Total Net Assets	$ 2,676,387	$ 2,632,161	$ 2,389,977

Assets. As of June 30, 2012, total assets amounted to $3.76 billion. The largest asset class was investment in capital (net of depreciation) that totaled $1.97 billion or 53 percent of total assets. Endowment investments were $947.4 million, or 25 percent of total assets and cash and cash equivalents totaled $334.7 million, or nine percent of total assets. During the year, total assets decreased by a net $16.6 million primarily because of a decrease in cash and cash equivalents of $45.1 million and other long-term investments of $68.6 million offset by capital additions of buildings and equipment of $65.8 million.

Liabilities. As of June 30, 2012, total liabilities amounted to $1.08 billion. Bonds and notes payable, capital leases and other long-term obligations issued for educational buildings, housing, the UK HealthCare Hospital System, equipment and computer software totaled $679.4 million, or 63 percent of total liabilities. During the year, total liabilities decreased by $60.8 million as a result of principal payments on bonds and capital leases and refunding of bonds offset by the addition of new capital lease obligations, primarily for the patient care facility, and increases in other post employment benefit liabilities.

Net Assets. The University's equity of $2.68 billion as of June 30, 2012 is reported on the Statement of Net Assets in four net asset categories: invested in capital assets, net of related debt, $1.30 billion (49 percent); restricted-nonexpendable $557.7 million (21 percent); restricted-expendable $242.2 million (nine percent); and unrestricted $577.3 million (21 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 $44.2 million during the year ended June 30, 2012. Invested in capital assets, net of related debt increased $80.7 million due to the additions of capital assets and principal payments of capital debt. Restricted net assets decreased $7.0 million principally as a result of loss on endowment investments due to a negative return on the endowment pool. Unrestricted net assets decreased $29.5 million, primarily due to an increase in operating revenues of $129.8 million offset by an increase in operating expenses of $148.4 million. Additionally, the negative return on the endowment pool caused a decrease in quasi endowment net assets of $6.6 million.

2011 Versus 2010. During the year ended June 30, 2011:

- Total assets increased by a net $230.2 million primarily due to an increase in endowment investments of $158.7 million because of favorable market conditions and an increase in capital additions of buildings and equipment of $135.3 million.

- Liabilities decreased $12.0 million primarily due to 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.

- 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 decrease in the UK HealthCare Hospital System and an increase of $63.5 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, 2012, with comparative information for the year ended June 30, 2011. 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.

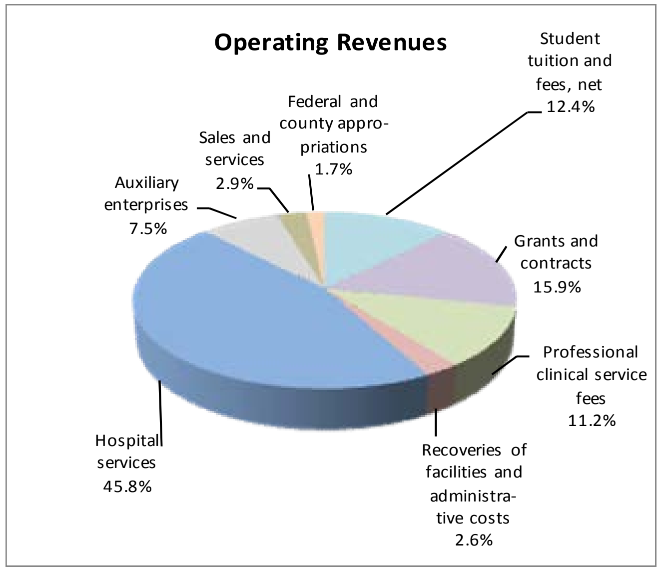
Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts, and investment and endowment income to be classified as nonoperating revenues. Accordingly, the University reports a net operating loss prior to the addition of nonoperating 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, 2012; June 30, 2011; and June 30, 2010 follows.

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

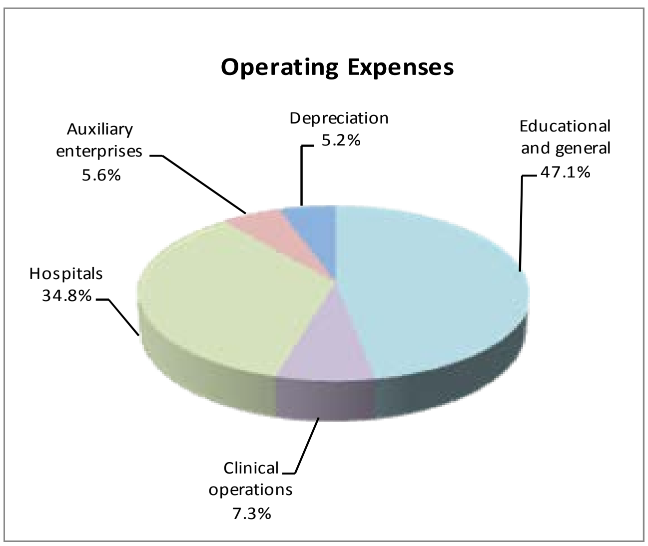
	2012	2011	2010
OPERATING REVENUES			
Student tuition and fees, net of scholarship allowances	$ 244,682	$ 222,904	$ 206,054
Grants and contracts	314,671	352,450	294,294
Hospital services	906,607	794,085	782,677
Professional clinical service fees	220,633	202,767	194,401
Auxiliary enterprises, net of scholarship allowances	149,216	137,966	133,831
Recoveries of facilities and administrative costs	51,818	53,086	50,847
Sales and services	56,064	51,720	47,196
Federal and county appropriations	33,986	34,823	31,784
Other operating revenues	2,631	1,927	1,508
Total operating revenues	1,980,308	1,851,728	1,742,592
OPERATING EXPENSES			
Educational and general, excluding depreciation	1,104,079	1,091,531	1,035,165
Clinical operations, excluding depreciation	169,848	143,864	150,107
Hospital, excluding depreciation	816,657	721,832	702,029
Auxiliary enterprises, excluding depreciation	131,121	126,901	124,145
Depreciation	122,219	111,859	101,832
Other operating expenses	1,102	667	1,702
Total operating expenses	2,345,026	2,196,654	2,114,980
NET LOSS FROM OPERATIONS	(364,718)	(344,926)	(372,388)
NONOPERATING REVENUES (EXPENSES)			
State appropriations	297,580	296,472	294,137
State fiscal stabilization fund	-	17,224	21,067
Capital appropriations	-	12,477	11,450
Capital grants and gifts	40,022	29,337	42,992
Gifts and non-exchange grants	88,468	88,396	78,295
Investment income (loss)	(232)	147,940	95,428
Interest on capital asset-related debt	(32,151)	(22,550)	(19,024)
Additions to permanent endowments	11,581	16,338	21,062
Other, net	3,676	1,476	3,877
Total nonoperating revenues (expenses)	408,944	587,110	549,284
Total increase (decrease) in net assets	44,226	242,184	176,896
Net assets, beginning of year	2,632,161	2,389,977	2,213,081
Net assets, end of year	$ 2,676,387	$ 2,632,161	$ 2,389,977

Total operating revenues were $1.98 billion for the year ended June 30, 2012, an increase of $128.6 million (seven percent). The primary components of operating revenues were student tuition and fees of $244.7 million; grants, contracts and recoveries of facilities and administrative costs of $366.5 million; hospital services of $906.6 million; and professional clinical fee income of $220.6 million.

The major increase was in hospital service revenue of $112.5 million primarily caused by an increase in rates, the overall case mix and patient discharges. Other significant increases in operating revenues related to net student tuition and fees of $21.8 million due to tuition and fee rate increases as well as increased enrollment; professional clinical service fees of $17.9 million due to increased patient activity offset by declining reimbursements; auxiliary enterprises net of scholarship allowances of $11.3 million and sales and services of $4.3 million. Grants and contracts decreased $37.8 million primarily resulting from decreases of state and local grants and contracts of $30.9 million resulting from a decrease in professional supplemental payments and federal grants and contracts of $7.8 million due to the reduction in funding from the American Recovery and Reinvestment Act of 2009.



Operating expenses totaled $2.35 billion, an increase of $148.4 million (seven percent). Of this amount, $1.10 billion (excluding depreciation) was expended for educational and general programs, including instruction, research and public service. Hospital System expenses, excluding depreciation, amounted to $816.7 million and clinical operations expenses, excluding depreciation, were $169.8 million. Depreciation expense for the year amounted to $122.2 million.



The most significant increase was in Hospital System expenses, excluding depreciation, of $94.8 million primarily due to additional staffing and supplies required for increased patient activities as stated above. Clinical operations expenses, excluding depreciation, increased $26.0 million due to increased patient activities. Instruction expenses increased primarily due to new faculty in the College of Arts and Sciences to support the University's General Education Reform and the College of Education to support growth in Science Technology Engineering and Mathematics education and Kinesiology. Depreciation expenses increased $10.4 million due to the addition of capital assets, primarily the patient care facility.

The net loss from operations for the year was $364.7 million. Nonoperating and other revenues, net of expenses, totaled $408.9 million and included: state appropriations of $297.6 million – an increase of $1.1 million offset by a decrease of $17.2 million in state fiscal stabilization funds; capital grants and gifts of $40.0 million – an increase of $10.7 million; gifts and non-exchange grants of $88.5 million – an increase of $72,000; and investment loss of $232,000 – a decrease of $148.2 million.

2011 Versus 2010. Total operating revenues were $1.85 billion for the year ended June 30, 2011, including: student tuition and fees of $222.9 million (12 percent); grants, contracts, and recoveries of facilities and administrative costs of $405.5 million (22 percent); professional clinical service fees of $202.8 million (11 percent); and hospital services of $794.1 million (43 percent). Operating revenues for fiscal year 2011 increased $109.1 million or six percent over fiscal year 2010, primarily due to increases in state and local grants and contracts of $44.5 million resulting from an increase in professional supplemental payments from the state; student tuition and fees of $16.9 million due to tuition and fees rate increases as well as increased enrollment; federal grants of $12.0 million resulting from the American Recovery and Reinvestment Act of 2009; hospital services revenue of $11.4 million and professional clinical service fees of $8.4 million due to fee schedule increases and volume.

Operating expenses totaled $2.20 billion in fiscal year 2011. Of this amount, $1.09 billion, excluding depreciation, or 50 percent was expended for educational and general programs, including instruction, research and public service. Hospital expenses, excluding depreciation, totaled $721.8 million, (33 percent) of the total expenses, and clinical operations expenses, excluding depreciation, were $143.9 million (seven percent). Depreciation amounted to $111.9 million (five percent). Operating expenses for fiscal year 2011 increased $81.7 million (four percent) over fiscal year 2010 primarily due to increases in public service of $50.2 million primarily due to the increase in professional supplemental payments funding this category as stated above; hospital expenses, excluding depreciation, of $19.8 million (three percent); instruction and research expenses of $13.4 million (five percent) and $7.0 million (three percent) respectively. Depreciation expense increased $10.0 million (17 percent), due primarily to the addition of related capital assets.

The net loss from operations for the 2011 fiscal year totaled $344.9 million. Nonoperating and other revenues, net of expenses, totaled $587.1 million, resulting in an increase in net assets of $242.2 million for the year. Nonoperating revenue included state appropriations of $296.5 million, which increased $2.3 million from June 30, 2010 to June 30, 2011.

Statement of Cash Flows

The Statement of Cash Flows details how cash has increased or decreased during the fiscal year ended June 30, 2012, with comparative financial information for the fiscal year ended June 30, 2011. 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, 2012; June 30, 2011; and June 30, 2010 follows:

Condensed Statement of Cash Flows (in thousands)

	2012	2011	2010
CASH PROVIDED (USED) BY:			
Operating activities	$ (286,354)	$ (228,807)	$ (257,232)
Noncapital financing activities	417,987	449,513	436,216
Capital and related financing activities	(253,701)	(255,258)	(191,256)
Investing activities	77,005	(78,944)	64,000
Net increase (decrease) in cash and cash equivalents	(45,063)	(113,496)	51,728
Cash and cash equivalents, beginning of year	379,786	493,282	441,554
Cash and cash equivalents, end of year	$ 334,723	$ 379,786	$ 493,282

The University's cash and cash equivalents decreased $45.1 million in fiscal year 2012. Total cash provided by operating and noncapital financing activities was $131.6 million, a decrease of $89.1 million compared to fiscal year 2011. Total cash used by capital financing activities was $253.7 million, reflecting both capital funding sources (debt proceeds) and uses (purchases of capital assets and debt service). Total cash provided by investing activities was $77.0 million.

Major sources of cash received from operating activities were student tuition and fees of $244.7 million; hospital services of $865.8 million; grants, contracts, and recoveries of facilities and administrative costs of $359.5 million; and professional clinical service fees of $222.7 million. Major uses of cash for operating activities were payments to employees for salaries and benefits of $1.46 billion and to vendors and contractors of $719.4 million.

Noncapital financing activities include state appropriations from the Commonwealth of Kentucky of $297.6 million; gifts of $103.8 million and other noncapital financing receipts of $16.3 million.

Capital and related financing activities include proceeds of capital debt of $38.6 million and capital grants and gifts of $35.1 million. Cash of $201.2 million was expended for construction and acquisition of capital assets and $90.7 million was expended for principal and interest payments on debt.

Investing activities include proceeds from sales and maturities of investments of $570.7 million and interest and dividends on investments of $23.0 million. Cash of $516.7 million was used to purchase investments.

2011 Versus 2010. Cash balances are lower when comparing fiscal year 2011 to fiscal year 2010. The $113.5 million net decrease in cash was created from less cash provided by noncapital and investing activities and more cash used for operating and capital related activities.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled $1.97 billion at June 30, 2012, an increase of $65.8 million. Capital assets as of June 30, 2012, 2011 and 2010, and significant changes in capital assets during the years ended June 30, 2011 and June 30, 2012 follow (in millions):

	Balance June 30, 2010	Net Additions FY 10-11	Balance June 30, 2011	Net Additions FY 11-12	Balance June 30, 2012
Land and land improvements	$ 143	$ 17	$ 160	$ 3	$ 163
Buildings, fixed equipment and infrastructure	1,667	491	2,158	153	2,311
Equipment, vehicles and capitalized software	589	36	625	63	688
Library materials and art	155	-	155	3	158
Construction in progress	444	(324)	120	(62)	58
Accumulated depreciation	(1,224)	(85)	(1,309)	(94)	(1,403)
Total	$ 1,774	$ 135	$ 1,909	$ 66	$ 1,975

At June 30, 2012, the University had capital construction projects in progress totaling approximately $88.6 million in scope. Major projects include the continuing construction of the fit-up of the Pharmacy Building, Track and Field Facility renovation, Softball Complex renovation, Sanders-Brown Center on Aging fourth floor renovation, the Nicholasville Road flood mitigation project, and Student Center Upgrade. The estimated cost to complete the projects in progress is approximately $30.4 million.

Debt

At June 30, 2012, capital debt amounted to $679.4 million, summarized by trust indenture and type as follows (in millions):

	2012	2011	2010
General Receipts bonds and notes	$ 500	$ 491	$ 481
Consolidated Educational Buildings Revenue Bonds	42	83	94
Capital lease obligations	115	134	153
Notes payable	22	24	26
Total	$ 679	$ 732	$ 754

Debt decreased $52.6 million during the year primarily due to the principal payments of $57.9 million for the University's debt obligations and bond refunding net decrease of $6.4 million offset by capital lease additions of $11.8 million.

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 citizens of the Commonwealth of Kentucky. The University's strong financial condition, as evidenced by the receipt of credit ratings of Aa2 and AA- from Moody's Investors Service and Standard & Poor's Ratings Services, respectively, will provide a high degree of flexibility in obtaining funds for future capital projects 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 Commonwealth of Kentucky continues to suffer from fiscal stress related to the economic downturn, a growing pension liability, and continued reliance on one-time budget balancing measures. According to a recent report to the Governor's Blue Ribbon Commission on Tax Reform, Kentucky faces a structural deficit that could reach $1 billion by 2020. The University's state support for fiscal years 2013 and 2014 is expected to be $283.9 million, a decrease of $13.7 million.
- Student demand is expected to remain high in the coming years. Even though tuition rates for fiscal year 2012-13 reflect a six percent increase, the University is expected to enroll the largest, most diverse and best prepared incoming freshmen class in the institution's history. Applications for the Fall 2012 incoming class increased over 24% to 18,802 as compared to the prior fall of 15,153. Preliminary numbers indicate that the fall 2012 entering freshmen class will total 4,645 students – an increase of 506 students, or 11%, compared to last fall. The tuition rate increases and projected enrollment are expected to generate additional operating revenues of at least $24.2 million compared to the fiscal year 2011-12 original budget.
- As of June 30, 2012, grants and contracts of approximately $191.5 million, a decrease of approximately $200.0 million from the previous year, have been awarded to the University but not expended. The decline in available governmental awards will result in reduced grant revenue in future periods.
- In April 2012, the University entered into a contract with Education Realty Trust (EdR) for the first phase of a plan to improve, expand and manage all campus student housing. Construction of two four-story buildings, which will comprise a 600-bed living-learning community with classrooms and meeting space on the former site of Haggin Field began in Spring 2012. It is anticipated that the facilities will open in Fall 2013. Phase II-A of the housing plan is currently under consideration and includes five facilities with 2,305 beds which are expected to open in Fall 2014. The total plan includes increasing the current on-campus housing stock to 9,000 beds by 2017. This comprehensive public/private partnership with EdR, the first of its kind in the nation, will provide a substantial increase in the quantity and quality of student housing while allowing the University to reserve its debt capacity to rebuild learning and research spaces.
- The new Patient Care Facility, with an estimated construction cost of $575.6 million, was initially authorized by the General Assembly and approved by the Board of Trustees in 2005. The emergency department, lobby, concourse and two patient floors opened in fiscal year 2010-11. In January 2012 eight operating rooms, a hybrid suite, and related post anesthesia and recovery unit, were completed. General Receipts notes and bonds in the amount of $366.3 million have been issued for this project with the remainder of the funding provided by cash reserves and an internal loan from the University's operating funds. Planning for future fit up of shelled space in Pavilion A is ongoing.
- 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 governments 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.
- 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 Top 20 public research institutions.

UNIVERSITY OF KENTUCKY
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY
STATEMENTS OF NET ASSETS (in thousands)
JUNE 30, 2012 AND 2011

	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents	$ 280,606	$ 302,838
Notes, loans and accounts receivable, net	254,101	212,179
Investments	8,408	10,989
Inventories and other assets	35,345	34,056
Total current assets	578,460	560,062
Noncurrent Assets		
Restricted cash and cash equivalents	54,117	76,948
Endowment investments	947,383	952,248
Other long-term investments	144,019	212,592
Notes, loans and accounts receivable, net	41,048	44,104
Other noncurrent assets	18,318	19,731
Capital assets, net	1,974,953	1,909,171
Total noncurrent assets	3,179,838	3,214,794
Total assets	3,758,298	3,774,856
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	177,645	190,296
Deferred revenue	62,852	68,625
Long-term liabilities - current portion	75,943	78,202
Total current liabilities	316,440	337,123
Noncurrent Liabilities		
Accounts payable and accrued liabilities	-	398
Long-term liabilities	765,471	805,174
Total noncurrent liabilities	765,471	805,572
Total liabilities	1,081,911	1,142,695
NET ASSETS		
Invested in capital assets, net of related debt	1,299,249	1,218,504
Restricted		
Nonexpendable		
Scholarships and fellowships	127,819	121,096
Research	261,843	257,830
Instruction	76,517	73,387
Academic support	83,549	83,388
Other	7,984	7,786
Total restricted nonexpendable	557,712	543,487
Expendable		
Scholarships and fellowships	46,172	54,513
Research	36,902	46,636
Instruction	36,138	40,468
Academic support	27,713	31,348
Loans	9,978	9,885
Capital projects	60,032	52,164
Debt service	4,120	5,859
Auxiliary	10,696	11,102
Other	10,406	11,449
Total restricted expendable	242,157	263,424
Total restricted	799,869	806,911
Unrestricted	577,269	606,746
Total net assets	$ 2,676,387	$ 2,632,161

See notes to financial statements.

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, 2012 AND 2011

	2012	2011
OPERATING REVENUES		
Student tuition and fees	$ 332,204	$ 305,456
Less: Scholarship allowances	(87,522)	(82,552)
Net tuition and fees	244,682	222,904
Federal grants and contracts	178,465	186,307
State and local grants and contracts	107,176	138,089
Nongovernmental grants and contracts	29,030	28,054
Recoveries of facilities and administrative costs	51,818	53,086
Sales and services	56,064	51,720
Federal appropriations	16,529	16,606
County appropriations	17,457	18,217
Professional clinical service fees	220,633	202,767
Hospital services	906,607	794,085
Auxiliary enterprises:		
Housing and dining	54,386	50,654
Less: Scholarship allowances	(6,656)	(7,391)
Net housing and dining	47,730	43,263
Athletics	69,307	66,527
Other auxiliaries	32,179	28,176
Other operating revenues	2,631	1,927
Total operating revenues	1,980,308	1,851,728
OPERATING EXPENSES		
Educational and general:		
Instruction	271,757	264,953
Research	260,969	271,292
Public service	272,960	273,662
Libraries	20,170	19,917
Academic support	85,004	81,158
Student services	34,489	30,980
Institutional support	61,837	55,231
Operations and maintenance of plant	67,435	65,601
Student financial aid	29,458	28,737
Depreciation	71,112	69,802
Total educational and general	1,175,191	1,161,333
Clinical operations (including depreciation of $1,816 in 2012 and $2,412 in 2011)	171,664	146,276
Hospital and clinics (including depreciation of $45,643 in 2012 and $35,500 in 2011)	862,300	757,332
Auxiliary enterprises:		
Housing and dining (including depreciation of $3,162 in 2012 and $3,612 in 2011)	45,254	43,777
Athletics (including depreciation of $486 in 2012 and $533 in 2011)	70,180	65,986
Other auxiliaries	19,335	21,283
Other operating expenses	1,102	667
Total operating expenses	2,345,026	2,196,654
Net loss from operations	(364,718)	(344,926)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	297,580	296,472
State fiscal stabilization fund	-	17,224
Gifts and non-exchange grants	88,468	88,396
Investment income (loss)	(232)	147,940
Interest on capital asset-related debt	(32,151)	(22,550)
Other nonoperating revenues and expenses, net	7,654	7,152
Net nonoperating revenues (expenses)	361,319	534,634
Net income (loss) before other revenues, expenses, gains or losses	(3,399)	189,708
Capital appropriations	-	12,477
Capital grants and gifts	40,022	29,337
Additions to permanent endowments	11,581	16,338
Other, net	(3,978)	(5,676)
Total other revenues (expenses)	47,625	52,476
INCREASE IN NET ASSETS	44,226	242,184
NET ASSETS, beginning of year	2,632,161	2,389,977
NET ASSETS, end of year	$ 2,676,387	$ 2,632,161

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, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Student tuition and fees	$ 244,724	$ 222,625
Grants and contracts	309,694	365,564
Recoveries of facilities and administrative costs	49,804	55,906
Sales and services	54,950	54,395
Federal appropriations	18,164	18,076
County appropriations	18,622	17,320
Payments to vendors and contractors	(719,376)	(677,925)
Student financial aid	(29,534)	(28,729)
Salaries, wages and benefits	(1,462,269)	(1,378,354)
Professional clinic service fees	222,721	200,401
Hospital services	865,793	793,157
Auxiliary enterprise receipts	146,504	135,628
Loans issued to students	(18,914)	(23,999)
Collection of loans to students	17,397	24,226
Self insurance receipts	41,852	62,505
Self insurance payments	(45,597)	(68,526)
Other operating receipts (payments), net	(889)	(1,077)
Net cash provided (used) by operating activities	(286,354)	(228,807)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	297,580	296,472
State fiscal stabilization fund	-	17,224
Gifts and grants received for other than capital purposes:		
Gifts received for endowment purposes	11,581	16,338
Gifts received for other purposes	92,206	87,081
Agency and loan program receipts	198,305	186,472
Agency and loan program payments	(197,994)	(185,221)
Other noncapital financing receipts (payments), net	16,309	31,147
Net cash provided (used) by noncapital financing activities	417,987	449,513
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital appropriations	-	12,476
Capital grants and gifts	35,051	32,167
Purchases of capital assets	(201,205)	(240,555)
Proceeds from capital debt	38,611	31,734
Payments to refunding bond agents	(33,115)	-
Proceeds from sales of capital assets	-	3
Principal paid on capital debt and leases	(57,476)	(59,447)
Interest paid on capital debt and leases	(33,270)	(33,964)
Other capital and related financing receipts (payments), net	(2,297)	2,328
Net cash provided (used) by capital and related financing activities	(253,701)	(255,258)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	570,747	967,265
Interest and dividends on investments	22,955	8,183
Purchase of investments	(516,697)	(1,054,392)
Net cash provided (used) by investing activities	77,005	(78,944)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(45,063)	(113,496)
CASH AND CASH EQUIVALENTS, beginning of year	379,786	493,282
CASH AND CASH EQUIVALENTS, end of year	$ 334,723	$ 379,786
Reconciliation of net loss from operations to net cash used by operating activities:		
Net loss from operations	$ (364,718)	$ (344,926)
Adjustments to reconcile net loss from operations to net cash used by operating activities:		
Depreciation expense	122,219	111,859
Change in assets and liabilities:		
Notes, loans and accounts receivable, net	(42,652)	13,296
Inventories and other assets	373	(3,477)
Accounts payable and accrued liabilities	6,479	3,725
Deferred revenue	(5,773)	(2,748)
Long-term liabilities	(2,282)	(6,536)
Net cash provided (used) by operating activities	$ (286,354)	$ (228,807)

See notes to financial statements.

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 Enterprises, 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.

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.

During the year ended June 30, 2012, the University adopted Statement of Governmental Accounting Standards Board (GASB) No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that statement for business-type activities to apply post-November 30, 1989, FASB statements and interpretations that do not conflict with or contradict GASB pronouncements. GASB No. 62 has been applied retrospectively and had no impact on the University's net assets, changes in net assets or financial reporting disclosures.

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.

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 the prevailing UPMIFA statute 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.

For the year ended June 30, 2012, the University's endowment standard spending rule provided for annual distributions of 4.25 percent of the sixty month moving average market value of fund units. In establishing the standard spending rule, the University balances the long-term expected return against the level of expenditures required to support the University's goals and objectives. In recognition of recent adverse market performance, reduced spending rules were established for certain endowments whose market value was less than the contributed value as of December 31, 2010.

For the year ended June 30, 2011, the University's endowment standard spending rule provided for annual distributions of 4.375 percent of the sixty month moving average market value of fund units.

The Investment Committee of the University's Board of Trustees has approved a standard spending rate distribution of 4.25% of a sixty month moving average market value of funds for the year ended June 30, 2013. Additionally, the Investment Committee has approved a standard management fee of 0.25 percent for the year ended June 30, 2013. However, for certain endowments whose market value was less than the contributed value as of December 31, 2011 reduced spending rules have been established and the funds will not be assessed a management fee.

The amount available for spending in accordance with the University's endowment spending policy was approximately $18,007,000 and $22,409,000 for the years ended June 2012 and 2011, respectively. Additionally, for the year ended June 30, 2012, the University assessed eligible endowment accounts with a management fee of 0.25 percent of total asset value. 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.

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.

The University's financial statements include alternative investments, such as limited partnerships, that are not publicly traded. Certain of these alternative investments are carried at their estimated fair values as of March 31, 2012 and 2011, as adjusted by cash receipts, cash disbursements, and securities distributions through June 30, 2012 and 2011, at a total estimated fair value of $90,486,000 and $57,612,000, respectively. In addition, the University also has alternative investments in investment funds that are not themselves publicly traded and thus do not have publicly reported market values, but whose underlying assets consist of publicly traded investments for which fair values are established by the major securities markets. Such alternative investments are carried at fair value of $274,618,000 and $278,409,000 at June 30, 2012 and 2011. The University believes that the total carrying amount of its alternative investments valued at $406,715,000 and $374,993,000 at June 30, 2012 and 2011 is a reasonable estimate of fair value. The University's outstanding commitment to alternative investments is $141,265,000 and $66,179,000 as of June 30, 2012 and 2011, respectively.

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. 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.

Compensated Absences. The amount of vacation leave earned but not taken by employees at June 30, 2012 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 23 percent, respectively, of the System's net patient services revenues (before the provision for doubtful accounts) for the year ended June 30, 2012 and approximately 25 percent and 24 percent, respectively for the year ended June 30, 2011. 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.

Electronic Health Records Incentive Program. The Electronic Health Records Incentive Program, enacted as part of the American Recovery and Reinvestment Act of 2009, provides for incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The System recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In fiscal year 2012, the System completed the first-year requirement under the Medicare programs and recorded revenue of approximately $2.0 million which is included in hospital services within operating revenues in the Statement of Revenues, Expenses, and Changes in Net Assets.

In fiscal year 2011, the System completed the first-year requirements under the Medicaid program and recorded revenue of approximately $2.9 million, which is included in hospital services within operating revenues in the Statement of Revenues, Expenses, and Changes in Net Assets.

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 24. During fiscal years 2012 and 2011, departmental research in nonsponsored accounts of $67,382,000 and $64,465,000, 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. GASB has issued certain statements which are applicable to the University for fiscal years ending after June 30, 2012. 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, 2012 and 2011 is as follows (in thousands):

	2012	2011
Deposits with banks and the Commonwealth of Kentucky	$ 37,049	$ 32,339
U.S. Treasury fixed income securities	12,171	13,999
Government agency fixed income securities	29,527	118,422
State and municipal fixed income securities	7,391	-
Common and preferred stocks	42,382	48,209
Pooled equity funds	361,994	368,030
Pooled private equity funds	71,791	46,228
Pooled absolute return funds	185,231	180,548
Pooled real return funds	89,387	97,861
Pooled real estate funds	62,006	52,245
Pooled fixed income funds	308,258	392,650
Corporate fixed income securities	28,913	22,122
Guaranteed investment contracts	762	323
Repurchase agreements	151,159	128,319
Certificates of deposit	27,450	19,245
Cash and cash equivalents	18,450	34,295
Other	612	780
Total	$ 1,434,533	$ 1,555,615

	2012	2011
Statement of Net Assets classification		
Cash and cash equivalents	$ 280,606	$ 302,838
Current investments	8,408	10,989
Restricted cash and cash equivalents	54,117	76,948
Endowment investments	947,383	952,248
Other long-term investments	144,019	212,592
Total	$ 1,434,533	$ 1,555,615

Alternative investments totaling $406,715,000 are included within pooled private equity funds, pooled absolute return funds, pooled real return funds and pooled real estate funds in the summary schedule of investments above (please refer to Note 1, Summary of Significant Accounting Policies, regarding valuation of alternative investments).

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 a short-term investment program of the University based on the Operating Fund Investment Policy. 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 Statements 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. treasury and agency securities; 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, 2012 and 2011, respectively, the credit quality of the University's fixed income investments is as follows (in thousands):

	2012								
	S&P/Moody's Credit Ratings								
	AAA/Aaa	AA/Aa	A	BBB/Baa	BB/Ba	B	Not rated	Rating Not Applicable	Total
U.S. treasury fixed income								$ 12,171	$ 12,171
Government agency fixed income	$ 29,527							-	29,527
State and municipal fixed income	-	$ 7,391						-	7,391
Pooled fixed income	-	-					$ 308,258	-	308,258
Corporate fixed income	-	107	$ 1,497	$ 27,309			-	-	28,913
Guaranteed investment contracts	19	-	-	-			743	-	762
Repurchase agreements	-	-	-	-			151,159	-	151,159
Certificates of deposit	-	-	-	-			27,450	-	27,450
Cash and cash equivalents	672	-	-	-			17,778	-	18,450
Total fixed income investments	$ 30,218	$ 7,498	$ 1,497	$ 27,309	$ -	$ -	$ 505,388	$ 12,171	$ 584,081

	2011								
	S&P/Moody's Credit Ratings								
	AAA/Aaa	AA/Aa	A	BBB/Baa	BB/Ba	B	Not rated	Rating Not Applicable	Total
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

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, 2012 and 2011, 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):

	2012					
	State Deposits	Overnight Investments	Bond Revenue Investments	Short-term Investments	Other State Investments	Total
Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the University's name		$ 168,000				$ 168,000
Uninsured, not registered in the name of the University and held by the counterparty but not in the University's name		-	$ 91,747	$ 60,303	$ 55,859	207,909
Total	$ -	$ 168,000	$ 91,747	$ 60,303	$ 55,859	$ 375,909

	2011					
	State Deposits	Overnight Investments	Bond Revenue Investments	Short-term Investments	Other State Investments	Total
Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the University's name		$ 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

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, 2012 and 2011, 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, 2012 and 2011, respectively, below is the maturity distribution of the University's fixed income investments (in thousands):

	2012						
	Maturities in Years						
Investment Type	Less than 1	1-3	3-5	5-10	Greater than 10	Managed based on duration	Total
U.S. treasury fixed income	$ 2,370	$ 10	$ 29	$ 70		$ 9,692	$ 12,171
Government agency fixed income	5,319	-	15,032	211		8,965	29,527
State and municipal fixed income	-	-	7,232	159		-	7,391
Pooled fixed income	-	-	-	-		308,258	308,258
Corporate fixed income	154	555	895	-		27,309	28,913
Guaranteed investment contracts	100	-	185	458	$ 19	-	762
Repurchase agreements	146,189	1,013	3,957	-	-	-	151,159
Certificates of deposit	27,450	-	-	-	-	-	27,450
Cash and cash equivalents	18,450	-	-	-	-	-	18,450
Total fixed income investments	$ 200,032	$ 1,578	$ 27,330	$ 898	$ 19	$ 354,224	$ 584,081

	2011						
	Maturities in Years						
Investment Type	Less than 1	1-3	3-5	5-10	Greater than 10	Managed based on duration	Total
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
Total fixed income investments	$ 223,214	$ 61,120	$ 2,757	$ 4,322	$ -	$ 437,962	$ 729,375

At June 30, 2012 and 2011, the University had the following investments managed based on duration (in thousands):

Investment Type	2012 Fair Value	2012 Modified Duration (Years)	2011 Fair Value	2011 Modified Duration (Years)
U.S. treasury fixed income securities				
Pooled endowment fund	$ 9,692	7.4	$ 7,569	7.1
Government agency fixed income securities				
Pooled endowment fund	8,965	4.2	17,088	4.1
Pooled fixed income funds				
Pooled endowment fund	98,191	2.4	123,393	4.4
Other endowment investments	2,091	5.3	2,463	5.5
Commonwealth of Kentucky short-term pool	144,579	0.2	191,276	0.1
Commonwealth of Kentucky intermediate pool	63,330	1.2	75,518	1.2
457 fund	32	5.1	-	-
KTI	35	4.5	-	-
Corporate fixed income securities				
Pooled endowment fund	27,309	3.7	20,655	3.3
Total	$ 354,224		$ 437,962	

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, 2012 and 2011, the following investments were subject to foreign currency risk (in thousands):

Endowment Investment	Fair Value 2012	Fair Value 2011
Common stock	$ 33,155	$ 49,463
Pooled private equity funds	7,262	7,165
Total	$ 40,417	$ 56,628

3. NOTES, LOANS AND ACCOUNTS RECEIVABLE, NET

Notes, loans and accounts receivable as of June 30, 2012 and 2011, respectively follows (in thousands):

	2012		
	Gross Receivable	Allowance	Net Receivable
Hospital patient accounts	$ 150,051	$ (34,786)	$ 115,265
Hospital third-party payer settlements	30,136	-	30,136
KMSF patient accounts	28,632	(5,131)	23,501
Dentistry patient accounts	2,476	(621)	1,855
Student loans	27,076	(2,333)	24,743
Reimbursement receivable - grants and contracts	40,689	(403)	40,286
Reimbursement receivable - federal appropriations	1,607	-	1,607
Pledges receivable	46,289	(17,930)	28,359
Accrued interest receivable	1,326	-	1,326
Student receivables	17,635	(8,993)	8,642
Other	19,429	-	19,429
Total	$ 365,346	$ (70,197)	$ 295,149
Current portion			$ 254,101
Noncurrent portion			41,048
Total			$ 295,149

	2011		
	Gross Receivable	Allowance	Net Receivable
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
Total	$ 313,942	$ (57,659)	$ 256,283
Current portion			$ 212,179
Noncurrent portion			44,104
Total			$ 256,283

4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2012 and capital asset activity for the year ended June 30, 2012 are summarized below (in thousands):

	June 30, 2011	Additions	Deletions	June 30, 2012
Land	$ 64,676	$ 80	$ 1,090	$ 63,666
Land improvements - nonexhaustible	36,216	1,231	-	37,447
Land improvements - exhaustible	59,270	2,572	-	61,842
Buildings	1,995,748	142,080	2,178	2,135,650
Fixed equipment - communications	74,957	8,982	-	83,939
Infrastructure	87,377	4,130	-	91,507
Equipment	500,450	73,671	32,629	541,492
Vehicles	20,838	2,011	2,218	20,631
Library materials	138,336	3,042	1,001	140,377
Nondepreciable library materials	6,578	23	-	6,601
Capitalized software	103,982	22,384	-	126,366
Art	10,501	490	-	10,991
Construction in progress	119,672	28,872	91,124	57,420
	3,218,601	289,568	130,240	3,377,929
Accumulated Depreciation				
Land improvements - exhaustible	49,141	1,851	-	50,992
Buildings	670,808	52,257	700	722,365
Fixed equipment - communications	42,956	4,580	-	47,536
Infrastructure	22,269	3,589	-	25,858
Equipment	336,959	45,977	25,769	357,167
Vehicles	17,603	1,527	2,204	16,926
Library materials	124,247	3,920	-	128,167
Capitalized software	45,447	8,518	-	53,965
	1,309,430	122,219	28,673	1,402,976
Capital assets, net	$ 1,909,171	$ 167,349	$ 101,567	$ 1,974,953

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

	June 30, 2010	Additions	Deletions	June 30, 2011
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
	2,998,090	630,026	409,515	3,218,601
Accumulated Depreciation				
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
	1,224,235	111,859	26,664	1,309,430
Capital assets, net	$ 1,773,855	$ 518,167	$ 382,851	$ 1,909,171

At June 30, 2012, the University had construction projects in progress totaling approximately $88.6 million in scope. The estimated cost to complete these projects was approximately $30.4 million. Such construction was principally financed by cash reserves, proceeds from the University's general receipts bonds, and 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 $562,000 for 2012 and $10,146,000 for 2011.

During fiscal year 2012 and 2011, the University utilized capital leases to acquire various items of equipment. As of June 30, 2012 and 2011, the net book value of land, buildings, equipment and software acquired through capital lease included in the above schedules totaled $160.1 million and $164.6 million, respectively.

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

	2012	2011
Capital lease additions	$ 2,113	$ 8,553
Gifts of capital assets	3,817	3,373
Capital asset additions in accounts payable	9,944	28,617
Capitalized interest, net of investment income	562	10,146
Amortized bond discount, premium and cost of issuance	713	386
Capital asset disposal, net	4,917	11,372
Capital asset trade in	4,337	1,594
Total	$ 26,403	$ 64,041

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2012 and 2011, respectively, follow (in thousands):

	2012	2011
Payable to vendors and contractors	$ 87,174	$ 98,545
Accrued expenses, including vacation and sick leave	45,060	62,368
Employee withholdings and deposits payable to third parties	45,411	29,781
Total	$ 177,645	$ 190,694
Current portion	$ 177,645	$ 190,296
Noncurrent portion	-	398
Total	$ 177,645	$ 190,694

6. DEFERRED REVENUE

Deferred revenue as of June 30, 2012 and 2011, respectively, follows (in thousands):

	2012	2011
Unearned summer school revenue	$ 7,249	$ 7,409
Unearned hospital revenue	6,583	6,670
Unearned grants and contracts revenue	30,837	36,282
Prepaid athletic ticket sales	11,644	13,797
Other	6,539	4,467
Total	$ 62,852	$ 68,625

7. LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2012 and long-term liability activity for the year ended June 30, 2012 are summarized below (in thousands):

	June 30, 2011	Additions	Reductions	June 30, 2012	Current Portion	Non-Current Portion
Bonds, notes and capital leases						
General receipts notes	$ 308,305		$ 13,775	$ 294,530	$ 14,355	$ 280,175
General receipts bonds	183,010	$ 25,370	3,290	205,090	5,795	199,295
Educational buildings bonds	82,760	-	40,360	42,400	4,440	37,960
Capital leases and other long-term obligations	133,892	11,863	30,931	114,824	31,161	83,663
Notes payable	23,983	-	1,405	22,578	1,921	20,657
Total bonds, notes and capital leases	731,950	37,233	89,761	679,422	57,672	621,750
Other liabilities						
Medical malpractice	28,855	2,081	5,162	25,774	2,734	23,040
Long-term disability	410	-	408	2	2	-
Annuities payable	5,212	103	515	4,800	439	4,361
Health insurance	6,451	34,795	35,346	5,900	5,900	-
Automobile and property self insurance	116	316	116	316	316	-
Retiree health benefits trust	48,597	9,276	151	57,722	-	57,722
Federal loan programs	21,425	465	768	21,122	-	21,122
Workers compensation	21,000	4,601	4,556	21,045	5,332	15,713
Compensated absences	6,500	1,155	-	7,655	517	7,138
Arbitrage rebate	2	375	2	375	375	-
Unamortized bond premium	9,269	4,253	986	12,536	986	11,550
Unemployment compensation	639	804	773	670	670	-
Other	2,950	4,053	2,928	4,075	1,000	3,075
Total other liabilities	151,426	62,277	51,711	161,992	18,271	143,721
Total	$ 883,376	$ 99,510	$ 141,472	$ 841,414	$ 75,943	$ 765,471

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

	June 30, 2010	Additions	Reductions	June 30, 2011	Current Portion	Non-Current Portion
Bonds, notes and capital leases						
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	754,175	39,798	62,023	731,950	57,701	674,249
Other liabilities						
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	133,916	89,510	72,000	151,426	20,501	130,925
Total	$ 888,091	$ 129,308	$ 134,023	$ 883,376	$ 78,202	$ 805,174

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 5.0 percent to 10.8 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 $687,275,000 dated May 1, 2001 through June 26, 2012, which bear interest at 1.50 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, 2028 and bear interest at 1.43 percent to 4.45 percent.

The indenture agreements require that certain funds be established with the trustee and with the Commonwealth of Kentucky. In addition, CEBRB 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 $7,168,000.

On June 26, 2012, $25,370,000 of University Kentucky General Receipts Bonds Series 2012A were issued at a net interest cost of 2.48%, representing a full refunding of CEBRB Series S and T bonds. These bonds were sold with a delivery date of June 26, 2012 and will reduce the University's total debt service payments over the next 12 years by approximately $6,262,000, representing an economic gain (difference between the present value of the debt service payments on the old and the new bonds) of approximately $5,507,000.

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, 2012, are as follows (in thousands):

	Principal	Interest	Total
2013	$ 57,672	$ 29,982	$ 87,654
2014	46,070	27,846	73,916
2015	41,985	26,126	68,111
2016	37,267	24,520	61,787
2017	54,892	22,757	77,649
2018-2022	181,966	86,377	268,343
2023-2027	168,060	44,376	212,436
2028-2032	46,915	16,485	63,400
2033-2037	26,305	9,072	35,377
2038-2040	18,290	1,590	19,880
Total	$ 679,422	$ 289,131	$ 968,553

At June 30, 2012, assets with a fair market value of approximately $80,698,000 have been placed on deposit with trustees to totally defease bonds with a par amount of $77,410,000. 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, 2012 and June 30, 2011, respectively, restricted expendable net assets were composed of the following (in thousands):

	2012	2011
Appreciation (depreciation) on permanent endowments	$ 38,637	$ 57,949
Term endowments	6,209	6,439
Quasi-endowments initially funded with restricted assets	40,560	42,094
Funds restricted for capital projects and debt service	64,152	58,023
Funds restricted for noncapital purposes	82,621	89,034
Loan funds (primarily University funds required for federal match)	9,978	9,885
Total	$ 242,157	$ 263,424

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, 2012 and June 30, 2011, respectively, are as follows (in thousands):

	2012	2011
Working capital requirements	$ 35,130	$ 75,768
Budget appropriations for future year fiscal operations	125,007	121,379
Designated for capital projects	43,696	26,917
Designated for renewal and replacement of capital assets	19,380	17,730
Hospital System	260,108	269,428
Affiliated corporations and component units	93,948	95,524
Total	$ 577,269	$ 606,746

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, 2012 and June 30, 2011, respectively, pledged revenues are as follows (in thousands):

	2012	2011
Student tuition and fees	$ 244,682	$ 222,904
Nongovernmental grants and contracts	985	1,334
Recoveries of facilities and administrative costs	51,818	53,086
Sales and services	40,741	39,126
Hospital services	906,607	794,085
Auxiliary enterprises - housing and dining	47,730	43,263
Auxiliary enterprises - other	32,179	28,176
Other operating revenue	976	1,036
State appropriations	297,580	296,472
Gifts and grants	5,012	4,543
Investment income	2,441	4,778
	$ 1,630,751	$ 1,488,803

11. INVESTMENT INCOME

Components of investment income (loss) for the years ended June 30, 2012 and June 30, 2011 are as follows (in thousands):

	2012	2011
Interest and dividends earned on endowment investments	$ 15,632	$ 6,159
Realized and unrealized gains and losses on endowment investments	(21,606)	135,405
Interest and dividends on cash and non-endowment investments	2,688	1,737
Realized and unrealized gains and losses on non-endowment investments	1,498	2,955
Investment income from external trusts	1,556	1,684
Total	$ (232)	$ 147,940

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, 2012 and 2011, the University received income from these trusts of approximately $1,556,000 and $1,684,000, respectively. The market value of the external trust assets as of June 30, 2012 and June 30, 2011 was approximately $49,652,000 and $52,639,000, 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, 2012, pledges are expected to be collected primarily over the next ten years, as follows (in thousands):

	2012	2011
Operating purposes	$ 10,950	$ 12,588
Capital projects	50,947	43,108
Total	61,897	55,696
Less discounts and allowances	(33,538)	(24,856)
Total	$ 28,359	$ 30,840

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, 2012 and 2011, the University recorded the discounted value of operating and capital pledges using a rate of three percent and four percent, respectively.

Deferred gifts through insurance, known bequests and irrevocable trusts in which the University has a remainder interest are estimated to be approximately $106,247,000 at June 30, 2012. The University records these amounts as revenue when the cash is received.

14. GRANTS AND CONTRACTS AWARDED

At June 30, 2012, grants and contracts of approximately $191,499,000 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 2012 and 2011 were approximately $86,212,000 and $75,288,000, respectively. Employees contributed approximately $42,653,000 in 2012 and $37,184,000 in 2011. The University's total payroll costs were approximately $1,103,624,000 and $1,046,451,000, respectively, for the years ended June 30, 2012 and 2011. The payroll for employees covered by the retirement plan was approximately $862,116,000 and $752,881,000 for the years ended 2012 and 2011, 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, 2012 and 2011.

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 $1,943,000 and $2,136,000 for the years ended June 30, 2012 and 2011, respectively.

The latest actuarial valuation was prepared as of July 1, 2012, 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 approximately $8,188,000.

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 2012, the University contributed $19.4 million to the plan. Plan members receiving benefits contributed 26.5 percent of the premium costs, an average for combined single and family coverage. In fiscal year 2012, total member contributions were approximately $3.7 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 plans to 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 $19.8 million is 3.5 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 2012 (in thousands):

Annual required contribution	$	19,798
Contributions made		(19,447)
Increase in net OPEB obligation/(asset)		351
Net OPEB obligation/(asset) - Beginning of year		(508)
Net OPEB obligation/(asset) - End of year	$	(157)

The University's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for fiscal year 2012, 2011 and 2010, were as follows (in thousands):

Fiscal Year Ended		Annual OPEB cost	Percentage of Annual OPEB Cost Contributed		Net OPEB Obligation/(Asset)
6/30/2010	$	23,300	96.9%	$	354
6/30/2011	$	23,999	103.6%	$	(508)
6/30/2012	$	19,798	98.2%	$	(157)

As of July 1, 2012, the actuarial accrued liability (AAL) for benefits was $239.1 million, with an actuarial value of assets of $57.7 million, resulting in an unfunded actuarial accrued liability (UAAL) of $181.4 million. The covered payroll (annual payroll of active employees covered by the plan) was $560.1 million and the ratio of the UAAL to the covered payroll was 32.4 percent at June 30, 2012. 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, 2012, net trust fund assets totaled $57.7 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, 2011 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 nine percent for the pre-65 members and eight percent for the post-65 members initially, reduced in decrements to an ultimate rate of six percent after seven years and three percent for pre-65 members and five percent for post 65 members after nine 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 2011 was 26 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 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 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 plans to 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 $2.0 million is 0.4 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 2012 (in thousands):

Annual required contribution	$	1,953
Contributions made		(2,361)
Increase in net OPEB obligation/(asset)		(408)
Net OPEB obligation/(asset) - Beginning of year		410
Net OPEB obligation/(asset) - End of year	$	2

The University’s annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for fiscal year 2012, 2011 and 2010 were as follows (in thousands):

Fiscal Year Ended	Annual OPEB cost		Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation/(Asset)	
6/30/2010	$	2,759	85.8%	$	400
6/30/2011	$	2,842	99.7%	$	410
6/30/2012	$	1,953	120.9%	$	2

As of July 1, 2012, the actuarial accrued liability (AAL) for benefits was $20.9 million and the actuarial value of assets was $11.9 million, resulting in an unfunded actuarial accrued liability (UAAL) of $9.0 million. The covered payroll (annual payroll of active employees covered by the plan) was $532.3 million and the ratio of the UAAL to the covered payroll was 1.7 percent at June 30, 2012.

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 heath 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, 2011 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. Benefits end when members recover, die, terminate employment or retire. For long-term disabilities arising at age 64 or later, the duration of LTD payments is limited to 12 months. Payments are assumed to be made until the later of (a) age 65 or (b) five years after date of disability. An employee approved for LTD benefits receives primary and supplemental payment benefits based on the employee's basic regular monthly salary at the time of onset of the disabling condition. Primary income benefits provide payment of 60% of the basic regular monthly salary less any disability received from government programs and/or other employers 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, workers' compensation or other similar government programs, veterans' or other governmental disability payments, or other employer-sponsored disability benefits.

The University provides supplemental payment benefits for 42 months following the date of disability onset based on the following schedule *(for current LTD participants OR employees approved for LTD benefits prior to October 1, 2006)*:

Months	Percentage of Salary
1-6	100%
7-18	90%
19-30	80%
31-42	70%
43-End of Benefit	60%

Claimants that file applications and who are approved for benefits on October 1, 2006 or after will have benefits based on the following schedule:

Months	Percentage of Salary
1-6	100%
7-End of Benefit	60%

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, 2011 was 26 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 2011 to 2012. 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, 2011 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, 2012.

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, 2012.

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 were 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, 2012, 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	$ 255
2008 Biennium: Capital Projects	21,927	21,927	21,927	3,644
2008 Biennium: RCTF	28,073	11,406	11,406	1,518
Total	$ 350,000	$ 235,524	$ 235,524	$ 5,417

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.

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

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

	2002 Biennium	2008 Biennium: Capital Projects	2008 Biennium: RCTF
Pledges due in fiscal year 2012 or prior	$ 255	$ 234	$ 68
Pledges due in fiscal year 2013	-	1,769	557
Pledges due in fiscal year 2014	-	1,641	578
Pledges due in fiscal year 2015	-	-	315
Total	$ 255	$ 3,644	$ 1,518

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, 2012 and June 30, 2011, respectively, follows (in thousands):

	2012	2011
Funds from private sources approved for match	$ 3,789	$ 1,835
Cigarette excise tax funds distributed	2,275	2,172
Total cancer research matching fund revenues	$ 6,064	$ 4,007
Cancer research matching fund expenses	$ 7,111	$ 7,758

23. STUDENT HOUSING PARTNERSHIP

Phase I:
The University has signed an agreement with a third party developer, Education Realty Trust (EdR), to construct two four-story buildings, which will comprise a 600-bed living-learning community with classrooms and meeting space on the former site of Haggin Field. The project, which is estimated to cost $28.6 million, is on land owned by the University and leased to EdR for a 50-year term with options for additional 10-year and 15-year terms thereafter. At the conclusion of the initial 50-year term or the first renewal option, the University will be required to purchase the buildings from EdR for an appraised value, unless the ground lease is renewed for the first or second optional extension. At the conclusion of the second optional extension, the University is required to purchase the buildings for the current net book value or $10. Ground rent will be equal to at least ten percent of gross revenues, with the potential for additional increments if additional beds are contracted with EdR and when EdR's internal rate of return is greater than nine percent in a given year. The University will account for the ground lease as an operating lease. The new housing facility is expected to open for the Fall 2013 semester.

Phase II:
Phase II of the proposed housing plan includes multiple projects to occur between October 2012 and July 2015. The University has received authorization from the Kentucky legislature of $175 million for the new projects, which the Commonwealth must approve statutorily even though EdR, not the University, is financing the projects. EdR is expected to eventually manage all of the University's housing operations.

24. NATURAL CLASSIFICATION

The University's operating expenses by natural classification were as follows for the years ended June 30, 2012 and June 30, 2011, respectively (in thousands):

	2012	2011
Salaries and wages	$ 1,115,457	$ 1,057,806
Employee benefits	352,820	323,792
Supplies and services	583,982	536,700
Depreciation	122,219	111,859
Student scholarships and financial aid	46,985	45,088
Purchased utilities	47,290	49,524
Other, various	76,273	71,885
Total	$ 2,345,026	$ 2,196,654

25. RECLASSIFICATIONS

Certain reclassifications to fiscal year 2011 comparative amounts have been made to conform to the fiscal year 2012 financial statement classifications. Certain transactions previously reported as an investment in stock are now being reported as an investment in pooled equity and certain transactions previously reported as restricted expendable other net assets are now being reported as restricted expendable capital projects net assets in the Statements of Net Assets. Certain transactions previously reported as student tuition and fees and sales and services are now being reported in Other Auxiliary revenue; and certain transactions previously reported as instruction and public service expenses are now being reporting in other auxiliary expenses in the Statements of Revenues, Expenses and Changes in Net Assets. Such classifications had no effect on the change in net assets.

26. CURRENT ECONOMIC CONDITIONS

The current economic situation 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 continuing uncertainty has made it challenging for many donors to continue to contribute to not-for-profit organizations. The last fiscal year has seen a decline in the fair value of investments due to current cash flow needs as well as a decline in current market conditions which has 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 U.S. health care system. The actual implementation of these Acts will happen over many years but UK Healthcare has begun to see the impact of the changes. The majority of the measures are designed to change the care delivery system but 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.

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, 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%
July 1, 2012	$ 57,722	$ 239,068	$ 181,346	24.1%	$ 560,092	32.4%

Schedule of Employer Contributions
(In thousands)

Year Ended	Annual Required Contributions	Percentage Contributed
June 30, 2010	$ 23,305	96.9%
June 30, 2011	$ 24,004	103.6%
June 30, 2012	$ 19,798	98.2%

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, 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%
July 1, 2012	$ 11,883	$ 20,898	$ 9,015	56.9%	$ 532,303	1.7%

Schedule of Employer Contributions
(In thousands)

Year Ended	Annual Required Contributions	Percentage Contributed
June 30, 2010	$ 2,761	85.7%
June 30, 2011	$ 2,844	99.7%
June 30, 2012	$ 1,953	120.9%

UNIVERSITY OF KENTUCKY
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY
STATEMENT OF NET ASSETS SCHEDULE
JUNE 30, 2012
(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
ASSETS											
Current Assets											
Cash and cash equivalents	$ 211,452	$ 36,713	$ 8,199	$ 8	$ 22,107	$ 63	$ 15	$ 11	$ 555	$ 1,483	$ 280,606
Notes, loans and accounts receivable, net	181,413	43,344	2,158	14	387					26,785	254,101
Investments		351								8,057	8,408
Inventories and other	29,163	2,462			3,652				12	56	35,345
Total current assets	422,028	82,870	10,357	22	26,146	63	15	11	567	36,381	578,460
Noncurrent Assets											
Restricted cash and cash equivalents	54,067						50				54,117
Endowment investments	933,091	3,598	190	7,505	265	1,160	1,574				947,383
Other long-term investments	99,184	1,472								43,363	144,019
Notes, loans and accounts receivable, net	40,142			14						892	41,048
Other noncurrent assets	15,898	2,250								170	18,318
Capital assets, net	1,920,486	15,092			1,804				224	37,347	1,974,953
Total noncurrent assets	3,062,868	22,412	190	7,519	2,069	1,160	1,624	-	224	81,772	3,179,838
Total assets	3,484,896	105,282	10,547	7,541	28,215	1,223	1,639	11	791	118,153	3,758,298
LIABILITIES											
Current Liabilities											
Accounts payable and accrued liabilities	147,184	17,815	436		2,109				567	9,534	177,645
Deferred revenue	17,341	33,799	67		11,645						62,852
Long-term liabilities - current portion	71,742	1,096			1,000					2,105	75,943
Total current liabilities	236,267	52,710	503	-	14,754	-	-	-	567	11,639	316,440
Noncurrent Liabilities											
Long-term liabilities	740,683	1,778			1,925					21,085	765,471
Total noncurrent liabilities	740,683	1,778	-	-	1,925	-	-	-	-	21,085	765,471
Total liabilities	976,950	54,488	503	-	16,679	-	-	-	567	32,724	1,081,911
INTERFUND BALANCES	(36,449)	3,520	839		6,995					25,095	-
NET ASSETS											
Invested in capital assets, net of related debt	1,267,580	13,907			1,804				224	15,734	1,299,249
Restricted											
Nonexpendable	551,053	755	31	4,607		616	650				557,712
Expendable	232,888	3,510	892	2,934	326	607	989	11			242,157
Total restricted	783,941	4,265	923	7,541	326	1,223	1,639	11	-	-	799,869
Unrestricted	492,874	29,102	8,282		2,411					44,600	577,269
Total net assets	$ 2,544,395	$ 47,274	$ 9,205	$ 7,541	$ 4,541	$ 1,223	$ 1,639	$ 11	$ 224	$ 60,334	$ 2,676,387

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, 2012
(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
OPERATING REVENUES											
Student tuition and fees, net	$ 244,682										$ 244,682
Federal grants and contracts	(148)	$ 178,613									178,465
State and local grants and contracts	32,642	73,843	$ 691								107,176
Nongovernmental grants and contracts	(4,271)	28,045	5,256								29,030
Recoveries of facilities and administrative costs	275	51,543									51,818
Sales and services	25,534	10,230	13,313					$ 20	$ 6,967		56,064
Federal appropriations	16,529										16,529
County appropriations	17,457										17,457
Professional clinical service fees	2,653									$ 217,980	220,633
Hospital services	906,607										906,607
Auxiliary enterprises:											
Housing and dining, net	47,730										47,730
Athletics					$ 69,307						69,307
Other auxiliaries	32,179										32,179
Other operating revenues	976									1,655	2,631
Total operating revenues	1,322,845	342,274	19,260	-	69,307	-	-	20	6,967	219,635	1,980,308
OPERATING EXPENSES											
Educational and general:											
Instruction	258,122	12,729	825			$ 6	$ 75				271,757
Research	87,344	173,393	227	$ 5							260,969
Public service	139,102	132,776	1,082								272,960
Libraries	20,166		4								20,170
Academic support	77,900	2,678	4,426								85,004
Student services	34,273	31	184			1					34,489
Institutional support	53,399	996	360					149	6,933		61,837
Operations and maintenance of plant	66,982	453									67,435
Student financial aid	25,818	1,719	1,880			41					29,458
Depreciation	69,599	1,427							86		71,112
Total educational and general	832,705	326,202	8,988	5	-	48	75	149	7,019	-	1,175,191
Clinical operations (including depreciation of $1,816)										171,664	171,664
Hospital (including depreciation of $45,643)	862,252		48								862,300
Auxiliary enterprises:											
Housing and dining (including depreciation of $3,162)	45,254										45,254
Athletics (including depreciation of $486)	(1,192)				71,372						70,180
Other auxiliaries	19,335										19,335
Other expenses	1,102										1,102
Total operating expenses	1,759,456	326,202	9,036	5	71,372	48	75	149	7,019	171,664	2,345,026
Net income (loss) from operations	(436,611)	16,072	10,224	(5)	(2,065)	(48)	(75)	(129)	(52)	47,971	(364,718)
NONOPERATING REVENUES (EXPENSES)											
State appropriations	297,580										297,580
Gifts and grants	87,998	131	151	95		1	6	86			88,468
Investment income (loss)	(477)	203	8	(58)	12	(9)	(12)		1	100	(232)
Interest on capital asset-related debt	(30,910)	(77)								(1,164)	(32,151)
Grant to/(from) the University for non-capital purposes	60,967	(8,570)	(11,699)	(364)	10,532	(4)	(4)			(50,858)	-
Other nonoperating revenues and expenses, net	4,051	1,285			2,318						7,654
Net nonoperating revenues (expenses)	419,209	(7,028)	(11,540)	(327)	12,862	(12)	(10)	86	1	(51,922)	361,319
Net income (loss) before other revenues, expenses, gains, or losses	(17,402)	9,044	(1,316)	(332)	10,797	(60)	(85)	(43)	(51)	(3,951)	(3,399)
Capital grants and gifts	16,638	23,471			1					(88)	40,022
Additions to permanent endowments	11,579	2									11,581
Grant to/(from) the University for capital purposes	48,326	(28,367)	(1,357)	(152)	(18,450)						-
Other, net	(3,491)	(482)			51					(56)	(3,978)
Total other revenues	73,052	(5,376)	(1,357)	(152)	(18,398)	-	-	-	-	(144)	47,625
INCREASE (DECREASE) IN NET ASSETS	55,650	3,668	(2,673)	(484)	(7,601)	(60)	(85)	(43)	(51)	(4,095)	44,226
NET ASSETS, beginning of year	2,488,745	43,606	11,878	8,025	12,142	1,283	1,724	54	275	64,429	2,632,161
NET ASSETS, end of year	$ 2,544,395	$ 47,274	$ 9,205	$ 7,541	$ 4,541	$ 1,223	$ 1,639	$ 11	$ 224	$ 60,334	$ 2,676,387

University of Kentucky
Governing Board as of June 30, 2012

UNIVERSITY OF
KENTUCKY

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.

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