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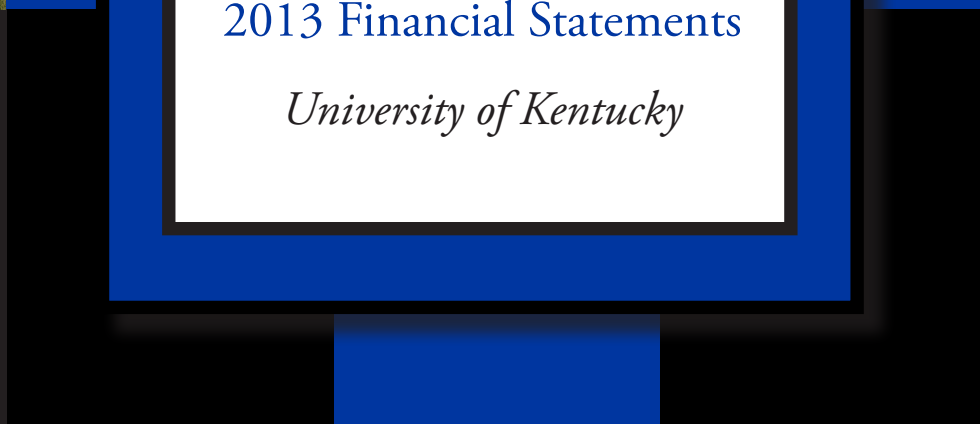


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UNIVERSITY OF  
**KENTUCKY**<sup>®</sup>  
 2013 Financial Statements  
*University of Kentucky*

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University of Kentucky  
A Component Unit of the Commonwealth of Kentucky  
Financial Statements  
Years Ended June 30, 2013 and 2012

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## MESSAGE FROM THE PRESIDENT



The University of Kentucky's commitment, created and nurtured in our land-grant heritage, is to be an unwavering guidepost for the state through our multi-faceted mission of teaching, research, service, and health care. Two years ago, we set forth, together, as a campus and a Board of Trustees on an ambitious path to renew our covenant with the people we serve.

We have responded with sharp and unrelenting focus on the priorities developed by the University Review Committee and the Board of Trustees. The overwhelming sentiment was to improve undergraduate education and the campus infrastructure while maintaining our progress in graduate education and research.

Our success over the last year has been the result of mutual interest in our future, an honest and open dialogue that included the voices of all university and community constituents, and the persistence of a deeply devoted Wildcat family.

Reaffirming our course, the University executed a successful reaffirmation visit from representatives of the Southern Association of Colleges and Schools Commission on Colleges (SACSCOC) in April 2013. Supported by literally hundreds of University faculty, staff and students, this process reaffirms the University's accreditation for the next 10 years.

The praise we received in our reaffirmation – made possible through the work of the Wildcat family – is evident elsewhere across campus:

- At 28,928 students, UK broke its enrollment record for the third year in a row; and research and professional practice doctoral enrollment reached a new high of 4,319.
- The mean ACT Composite for the Fall 2012 first-year class was 25.5 and included 427 students from the Governor's School for the Arts/Governor's Scholars Program.
- The first-year class included 71 National Merit and National Achievement Scholars, placing UK 11<sup>th</sup> among public universities in the number of scholars.
- In Fall 2012, minority and international student enrollment accounted for 18 percent of the total headcount with a record 1,561 African American and 526 international undergraduate students.
- In 2012-2013, UK awarded 6,185 degrees including 864 research and professional doctorates.
- In 2012-13, the University received \$265.9 million in external research grants and contracts -- signifying that we are a major player among research institutions in the country.
- UK completed a strong year in philanthropy, securing \$128.4 million in gifts and pledges from nearly 58,000 donors—a 21.8 percent increase in total gifts and pledges and a 4.0 percent increase in our donor base.

To build on our progress as one university, we opened and extended our budget process. The end result was a budget that invests in our priorities by:

- Holding the institution's annual tuition and fee increase to three percent – the lowest increase in 15 years.
- Supporting our students with more than \$7 million in additional financial aid and scholarships.
- Investing and rewarding our faculty and staff with a five percent merit salary pool.
- And, self-financing approved capital projects essential to the University.

We are in the second year of a multi-year process to create, refine and implement a financial model of accountability that will empower colleges with the necessary information to implement long-term plans and move their units forward. Over the last year, we collected important feedback from campus stakeholders that improved the effectiveness of the model. In

the year ahead, we will simulate the model's implementation, measure its impact and continue to amend the model based on our findings.

The University's public/private partnership with EdR continues to make progress. In August, we opened the doors to Central Halls I & II, adding 601 modern resident beds, new academic learning space and administrative offices for the Honors Program.

Currently, Phases II-A and II-B are underway. Eight additional facilities across campus will add nearly 4,000 beds and 156 active learning spaces by 2015. The investment thus far – nearly \$265 million – will transform the way we house, educate and mentor our students.

Thanks to the support of the Governor, scores of legislators, students, faculty, staff, alumni and friends, House Bill 7 – legislation authorizing UK to self-finance three building projects – was overwhelmingly approved. The capital priorities include:

- A dramatic renovation and expansion of the Gatton College of Business and Economics, which is made possible through the generosity of our donors.
- A new Academic Science Building that will accommodate the next century of scientific learning, research and discovery. UK Athletics is funding nearly two-thirds of this project – illustrating their unwavering support for our academic mission.
- And a renovation of Commonwealth Stadium and the Nutter Training and Recruiting Center; financed completely by Athletics. The investments we make today ensure our place as a premier, self-supporting program in the future -- one that provides nearly 500 scholarships to students from all walks of life and throughout the country.

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.

These capital projects will be integrated into our updated campus master plan. The Plan recognizes that the campus is more than the functional arrangement of buildings, roads, walkways, parking lots and landscapes. It is a community, defined by the collective experiences of our students, faculty, staff, visitors, surrounding neighborhoods and businesses.

Our momentum is evident across the entire campus. The Markey Cancer Center recently announced its designation as a National Cancer Center by the National Cancer Institute. This designation places UK among an elite group of 22 research universities with the triple crown of federal research awards: NCI-designation, the Clinical Translational Sciences Award and a federally supported Alzheimer's Disease Center.

The company we keep signals that UK is, without question, among the top research universities in the nation. More importantly, it means we are among the leaders in confronting the great medical challenges of our time, and – increasingly – finding treatments for those in our care.

We are in a time of opportunity and challenge 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. At the same time, more is being asked of us -- and more is expected from us -- in terms of ensuring affordable access to the education we provide -- an education that produces a differentiated graduate who is ready to compete and thrive in a complex world.

Because of the lives we touch, the improved general welfare of our society and the betterment of our way of life, we will never step back from our obligation as the Commonwealth's flagship and land-grant research university.

We can, we must and we will honor and extend the legacy of the last 150 years for another generation.



Eli Capilouto  
President

## Independent Auditor's Report on Financial Statements and Supplementary Information

Board of Trustees  
University of Kentucky  
Lexington, Kentucky

### Report on the Financial Statements

We have audited the accompanying basic financial statements of the University of Kentucky (University), a component unit of the Commonwealth of Kentucky, which are comprised of statements of net position as of June 30, 2013 and 2012, and statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the financial statements, as listed in the table of contents.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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 \$113,367,630 and \$118,480,156 as of June 30, 2013 and 2012, respectively, and total revenues of \$207,099,264 and \$203,140,877, respectively, for the years then ended. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for KMSF, is based solely on the report of the other auditors.

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 from material misstatement. The financial statements of KMSF, which is included in the University's reporting entity, were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the University's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and post-employment and long-term disability benefit plan information 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.

## **Other Information**

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The governing board 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.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 1, 2013, 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* in considering the University's internal control over financial reporting and compliance.

*BKD, LLP*

Louisville, Kentucky  
October 1, 2013

# 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, 2013 and 2012. 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
- Personal and institutional responsibility and accountability
- Shared governance
- A sense of community
- 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:

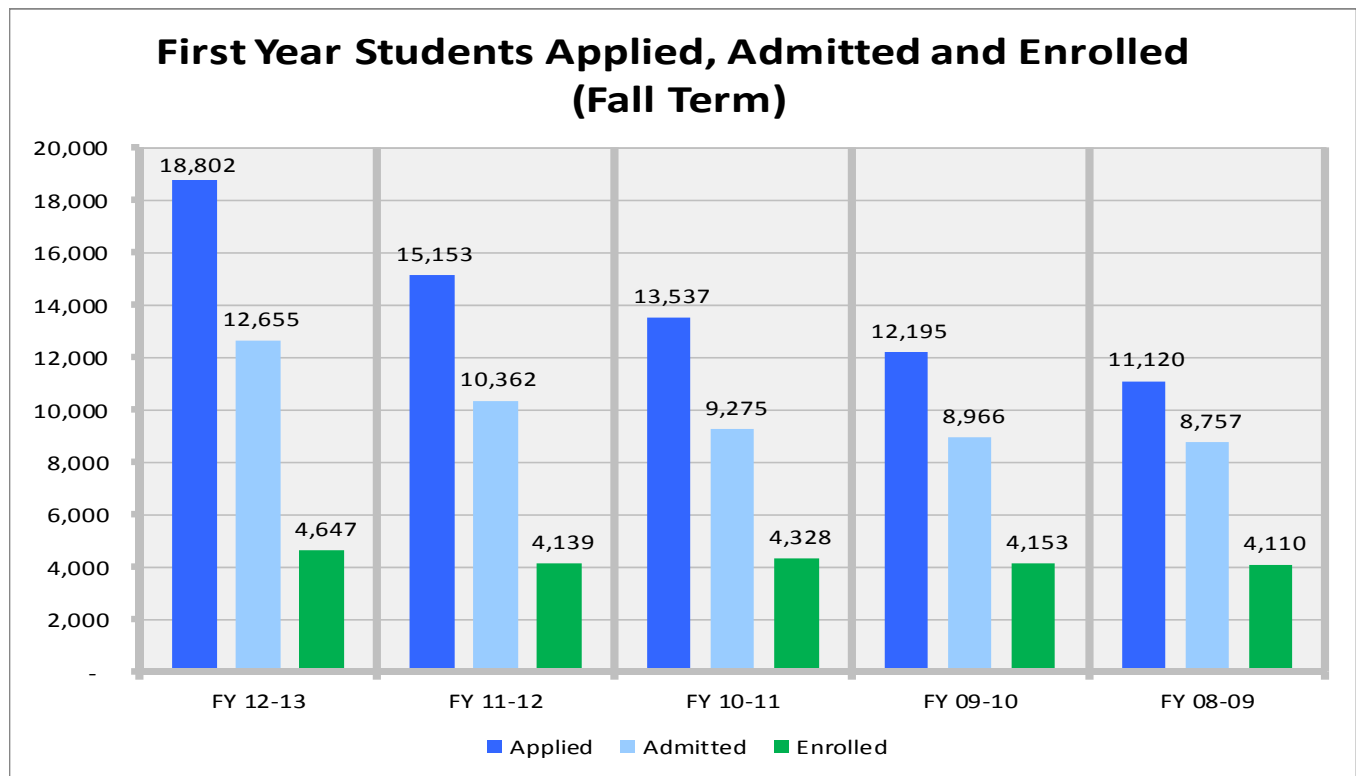
- Prepare Students for Leading Roles in an Innovation-driven Economy and Global Society
- Promote Research and Creative Work to Increase the Intellectual, Social, and Economic Capital of Kentucky and the World Beyond Its Borders
- Develop the Human and Physical Resources of the University to Achieve 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 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 – to produce graduates prepared for a 21<sup>st</sup> 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 is identified as a “Research University (very high research activity)” by the Carnegie Commission on Higher Education. There are 108 such institutions in the United States (out of approximately 3,600 colleges and universities).

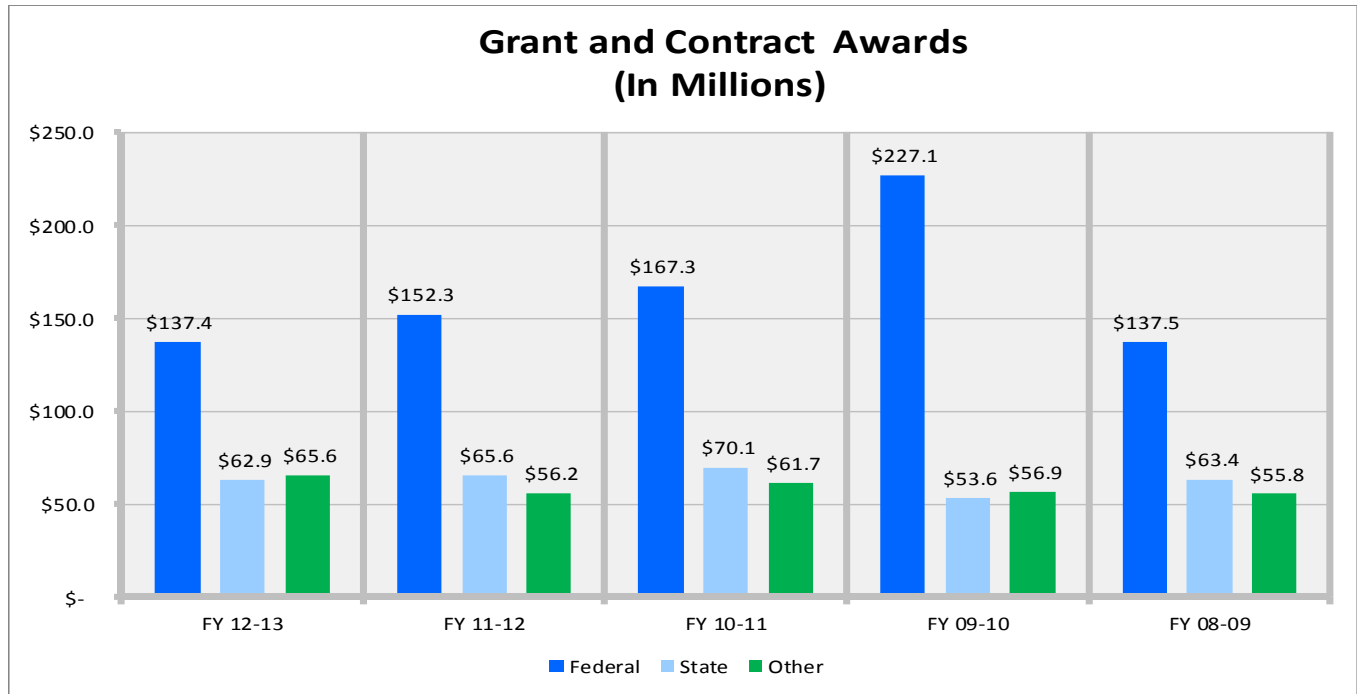
The University is accredited by the Commission on Colleges (CoC) of the Southern Association of Colleges and Schools (SACS). This has been re-affirmed at approximately 10-year intervals since 1915, with the next accreditation review scheduled to begin in 2022. In addition, several degree programs and individual units are accredited by agencies appropriate to specific professions or fields.

**Students.** In Fall 2012, the University had 28,928 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 3,500 students (14%) since Fall 2003.



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

**Research.** Total research expenditures, as reported to the National Science Foundation (NSF), totaled \$360.8 million for fiscal year 2011-12, compared to \$373.0 million in 2010-11. Research awards received during fiscal year 2012-13 total \$265.9 million, a three percent decrease from the prior year amount of \$274.1. The University's annual research awards peaked in fiscal year 2009-10 as result of the temporary stimulus funding available as part of the American Recovery and Reinvestment Act.



**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 Hospital System (the System) operates three hospital units under one Joint Commission Accreditation and two licenses in addition to multiple ambulatory services. The major service units include Albert B. Chandler Hospital, Kentucky Children's Hospital, Good Samaritan Hospital, Markey Cancer Center, Gill Heart Institute and the Kentucky Clinic. The System has a combined total of 825 licensed beds. The System leases 44 beds to Select Specialty Hospitals for use as a long-term acute care hospital, and operates 718 beds at an average daily census of 577 patients. On a monthly basis, the System provides over: 1,147 inpatient surgeries, 1,240 outpatient surgeries, 27,915 radiology procedures, 7,396 emergency department visits and 30,685 hospital based outpatient clinic visits.

In July 2013, UK HealthCare was designated as a National Cancer Institute (NCI) Cancer Center, a significant achievement for both the medical center and the state of Kentucky, strengthening its reputation as a frontrunner in cancer treatment and research. As the only designated program in the state and one of only 68 programs nationwide, NCI designated centers offer advanced treatment options, broader access to groundbreaking clinical trials and realize significantly improved survival rates over non-designated peers. With the NCI designation, UK HealthCare also joined an elite group of only 22 medical centers in the United States with a federally funded Alzheimer's disease center, Clinical and Translational Science Awards grant and NCI programs.

UK HealthCare and the Kentucky Cabinet for Health and Family Services recently entered into a contract under which the System will operate and manage Eastern State Hospital when it opens to patients in September 2013. The new \$129 million, 300,000 square-foot facility will be located on the University's Coldstream Research Campus, providing a modern setting for both acute and long-term inpatient psychiatric treatment for adults living within Fayette County and the 50 surrounding counties.

**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 \$3.95 billion and liabilities of \$1.08 billion as of June 30, 2013. Net position, which represents the University's residual interest in assets after liabilities and deferred inflows of resources are deducted, was \$2.87 billion (73% of total assets.)

- Total assets increased \$179.5 million (five percent), primarily due to increases in endowment investments and cash and cash equivalents, offset by decreases in net capital assets and accounts receivable.
- Total liabilities decreased \$10.6 million (one percent), primarily due to increases in accounts payable and accrued liabilities and unearned revenue and decreases in bonds and capital lease obligations.
- Total net position increased \$189.5 million (seven percent). Unrestricted net position increased \$110.0 million and restricted net position increased \$82.8 million largely due to investment gains on endowments. There was a decrease in net investment in capital assets of \$3.3 million.
- Operating revenues were \$2.01 billion and operating expenses were \$2.33 billion, resulting in a loss from operations of \$317.1 million. Nonoperating and other revenues, net of nonoperating expenses, were \$506.7 million, including \$283.9 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 Position
- Statement of Revenues, Expenses, and Changes in Net Position
- Statement of Cash Flows
- Notes to the Financial Statements

### **Reporting Entity**

The University is a component unit of the Commonwealth of Kentucky (Commonwealth). 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.
- 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 Position

The Statement of Net Position is the University's balance sheet. It reflects the total assets, liabilities, net position (equity), and deferred outflows and inflows of resources of the University as of June 30, 2013, with comparative information as of June 30, 2012. 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 position (i.e. the difference between total assets and total liabilities and deferred inflows of resources) are an important indicator of the University's current financial condition, while the change in net position is an indicator of whether the overall financial position has improved or worsened during the year. Generally, assets and liabilities and deferred inflows of resources 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, deferred inflows of resources, and net position as of June 30, 2013, 2012 and 2011 follows:

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>			
Current assets	\$ 664,460	\$ 591,917	\$ 560,062
Capital assets, net of depreciation	1,944,122	1,974,953	1,909,171
Other noncurrent assets	1,342,691	1,204,885	1,305,623
Total assets	<u>3,951,273</u>	<u>3,771,755</u>	<u>3,774,856</u>
<b>LIABILITIES AND DEFERRED INFLOWS OF RESOURCES</b>			
Current liabilities	327,521	329,897	337,123
Noncurrent liabilities	757,223	765,471	805,572
Deferred inflows of resources	561	-	-
Total liabilities and deferred inflows of resources	<u>1,085,305</u>	<u>1,095,368</u>	<u>1,142,695</u>
<b>NET POSITION</b>			
Net investment in capital assets	1,295,952	1,299,249	1,218,504
Restricted			
Nonexpendable	567,676	557,712	543,487
Expendable	315,025	242,157	263,424
Unrestricted	<u>687,315</u>	<u>577,269</u>	<u>606,746</u>
Total net position	<u>\$ 2,865,968</u>	<u>\$ 2,676,387</u>	<u>\$ 2,632,161</u>

**Assets.** As of June 30, 2013, total assets amounted to \$3.95 billion. The largest asset class was capital assets, net of depreciation that totaled \$1.94 billion or 49% of total assets. Endowment investments were \$1.05 billion, or 27% of total assets and cash and cash equivalents totaled \$451.9 million, or 11% of total assets. During the year, total assets increased by a net \$179.5 million primarily because of an increase in cash and cash equivalents of \$103.7 million, endowment investments of \$107.1 million, and other long-term investments of \$17.6 million offset by a decrease in capital assets of \$30.8 million and notes, loans and accounts receivable, net of \$15.3 million.

**Liabilities.** As of June 30, 2013, total liabilities amounted to \$1.08 billion. Bonds and notes payable and capital leases and other long-term obligations issued for educational buildings, housing, the UK HealthCare Hospital System, equipment and computer software totaled \$647.8 million, or 60% of total liabilities. During the year, total liabilities decreased by \$10.6 million as a result of principal payments on bonds and capital leases and refunding of bonds net of the addition of new capital lease obligations, primarily for the patient care facility offset by an increase in accounts payable and accrued liabilities and unearned revenue.

**Net Position.** The University's equity of \$2.87 billion as of June 30, 2013 is reported on the Statement of Net Position in three net position categories: net investment in capital assets, \$1.30 billion (45%); restricted-nonexpendable, \$567.7 million (20%) and restricted-expendable, \$315.0 million (11%); and unrestricted, \$687.3 million (24%).

Restricted net position is subject to externally imposed restrictions governing its use. Although unrestricted net position is not subject to externally imposed stipulations, most of the unrestricted net position has been internally designated for support of academic and research programs and initiatives, capital projects and working capital requirements.

Total net position increased \$189.5 million during the year ended June 30, 2013. Net investment in capital assets decreased \$3.3 million due to depreciation expense and demolition of residential halls for the Education Realty Trust (EdR) housing project in excess of additions of capital assets and principal payments of capital debt. Restricted net position increased \$82.8 million principally as a result of gain on endowment investments due to a positive return on the endowment pool. Unrestricted net position increased \$110.0 million, primarily due to an increase in operating revenues of \$32.9 million along with a decrease in operating expenses of \$13.1 million. Additionally, the positive return on the endowment pool caused an increase in quasi endowment net position of \$24.3 million.

**Deferred Inflows of Resources.** The University's deferred inflows of resources totaled \$561 thousand. This represents the fair value of a derivative instrument that provides a specified rate of return on debt service investments.

**2012 Versus 2011.** During the year ended June 30, 2012:

- Total assets decreased by a net \$3.1 million primarily due to a decrease in other long-term investments of \$68.6 million offset by capital additions of buildings and equipment of \$65.8 million.
- Liabilities decreased \$47.3 million primarily due to 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.
- Total net position increased \$44.2 million during the year ended June 30, 2012. Net investment in capital assets increased \$80.7 million due to the additions of capital assets and principal payments of capital debt. Restricted net position decreased \$7.0 million principally as a result of loss on endowment investments due to a negative return on the endowment pool. Unrestricted net position decreased \$29.5 million primarily due to an increase in operating revenues of \$130.3 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 position of \$6.6 million.

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

The Statement of Revenues, Expenses and Changes in Net Position is the University's income statement. It details how net position has changed during the year ended June 30, 2013, with comparative information for the year ended June 30, 2012. 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 position appear on the Statement of Revenues, Expenses and Changes in Net Position as revenues, expenses, gains or losses.

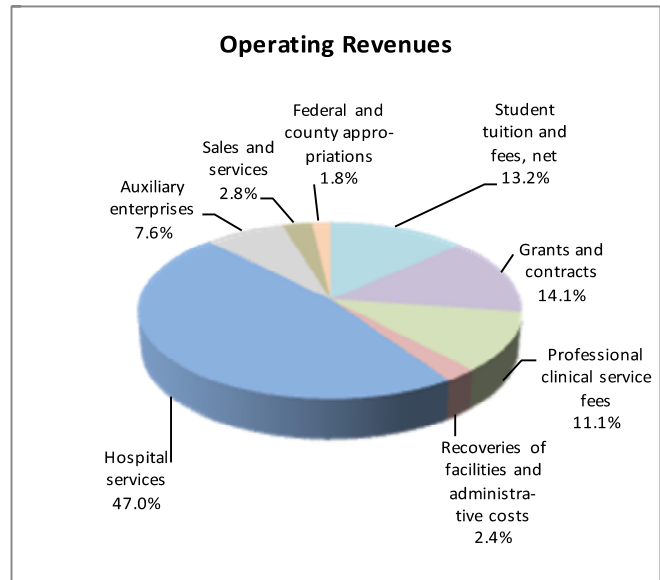
Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts, and investment income to be classified as nonoperating revenues. Accordingly, the University reports a net operating loss prior to the addition of nonoperating revenues. 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 position for years ended June 30, 2013, 2012 and 2011 follows.

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

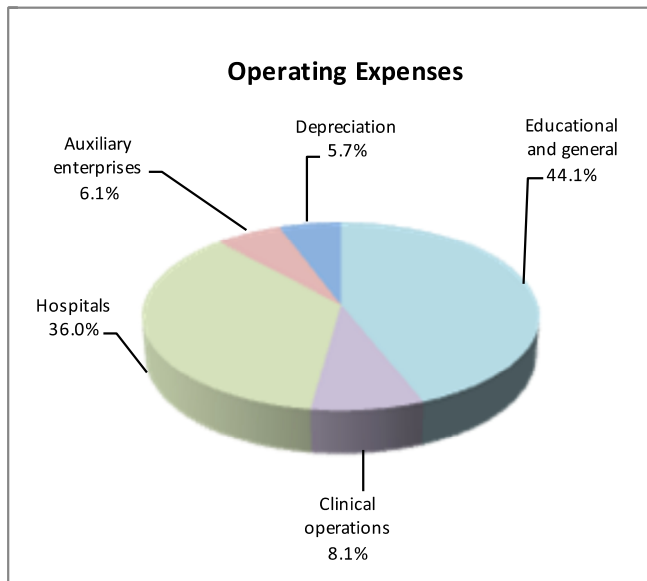
	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>OPERATING REVENUES</b>			
Student tuition and fees, net of scholarship allowances	\$ 265,293	\$ 243,364	\$ 222,904
Grants and contracts	283,378	317,722	352,450
Hospital services	945,885	906,607	794,085
Professional clinical service fees	222,475	220,633	202,767
Auxiliary enterprises, net of scholarship allowances	153,006	149,216	137,966
Recoveries of facilities and administrative costs	47,862	51,818	53,086
Sales and services	57,022	56,064	51,720
Federal and county appropriations	36,202	33,986	34,823
Other operating revenues	3,772	2,631	1,927
Total operating revenues	<u>2,014,895</u>	<u>1,982,041</u>	<u>1,851,728</u>
<b>OPERATING EXPENSES</b>			
Educational and general, excluding depreciation	1,026,076	1,096,030	1,079,265
Clinical operations, excluding depreciation	189,664	168,910	143,668
Hospital, excluding depreciation	840,064	823,421	730,987
Auxiliary enterprises, excluding depreciation	142,416	133,344	130,208
Depreciation	133,066	122,219	111,859
Other operating expenses	682	1,102	667
Total operating expenses	<u>2,331,968</u>	<u>2,345,026</u>	<u>2,196,654</u>
<b>NET LOSS FROM OPERATIONS</b>	<u>(317,073)</u>	<u>(362,985)</u>	<u>(344,926)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>			
State appropriations	283,869	297,580	296,472
State fiscal stabilization fund	-	-	17,224
Capital appropriations	-	-	12,477
Capital grants and gifts	30,672	40,022	29,337
Gifts and non-exchange grants	98,418	86,735	88,396
Investment income (loss)	104,748	(232)	147,940
Interest on capital asset-related debt	(29,244)	(32,151)	(22,550)
Additions to permanent endowments	10,225	11,581	16,338
Other, net	7,966	3,676	1,476
Total nonoperating revenues (expenses)	<u>506,654</u>	<u>407,211</u>	<u>587,110</u>
Total increase in net position	189,581	44,226	242,184
Net position, beginning of year	<u>2,676,387</u>	<u>2,632,161</u>	<u>2,389,977</u>
Net position, end of year	<u>\$ 2,865,968</u>	<u>\$ 2,676,387</u>	<u>\$ 2,632,161</u>

Total operating revenues were \$2.01 billion for the year ended June 30, 2013, an increase of \$32.9 million (two percent). The primary components of operating revenues were student tuition and fees of \$265.3 million; grants, contracts and recoveries of facilities and administrative costs of \$331.2 million; hospital services of \$945.9 million; and professional clinical fee income of \$222.5 million.

The major increase was in hospital service revenue of \$39.3 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 \$21.9 million due to tuition and fee rate increases as well as increased enrollment; professional clinical service fees of \$1.8 million due to increased patient activity offset by declining reimbursements; auxiliary enterprises net of scholarship allowances of \$3.8 million and sales and services of \$1.0 million. Grants and contracts decreased \$34.3 million primarily resulting from decreases of state and local grants and contracts of \$21.4 million resulting from a decrease in Department of Corrections Health Care Network grant and federal grants and contracts of \$15.0 million due to the reduction in funding from the American Recovery and Reinvestment Act of 2009.



Operating expenses totaled \$2.33 billion, a decrease of \$13.1 million (less than one percent). Of this amount, \$1.03 billion (excluding depreciation) was expended for educational and general programs, including instruction, research and public service. Hospital System expenses, excluding depreciation, amounted to \$840.1 million and clinical operations expenses, excluding depreciation, were \$189.7 million. Depreciation expense for the year amounted to \$133.1 million.



Education and general programs expenses, excluding depreciation, decreased \$70.0 million due primarily to decreases in grants and contracts funding as stated above. Instruction expenses decreased \$11.3 million; research expenses decreased \$15.2 million and public service expenses decreased \$36.6 million. Offsetting these decreases was an increase in clinical operations expenses, excluding depreciation, of \$20.8 million primarily due to increased patient activities. Hospital System expenses, excluding depreciation, increased \$16.6 million due to additional staffing and supplies required for increased patient activities. Auxiliary enterprise expenses, excluding depreciation, increased \$9.1 million primarily in the athletics department for coaches' salaries and benefits. Depreciation expense increased \$10.8 million due to the addition of capital assets, primarily the patient care facility.

The net loss from operations for the year was \$317.1 million. Nonoperating and other revenues, net of expenses, totaled \$506.7 million and included: state appropriations of \$283.9 million – a decrease of \$13.7 million. Capital grants and gifts totaled \$30.7 million – a decrease of \$9.4 million; gifts and non-exchange grants of \$98.4 million – an increase of \$11.7 million; and an investment gain of \$104.7 million – an increase of \$105.0 million.

**2012 Versus 2011.** Total operating revenues were \$1.98 billion for the year ended June 30, 2012, including: student tuition and fees of \$243.4 million (12%); grants, contracts, and recoveries of facilities and administrative

costs of \$369.5 million (19%); professional clinical service fees of \$220.6 million (11%); and hospital services of \$906.6 million (46%). Operating revenues for fiscal year 2012 increased \$130.3 million or seven percent over fiscal year 2011, primarily due to increases in hospital services revenue of \$112.5 million resulting from an increase in rates, the overall case mix and patient discharges; student tuition and fees of \$20.5 million due to tuition and fees rate increases as well as increased enrollment; and professional clinical service fees of \$17.9 million due to increased patient activity offset by declining reimbursements; and auxiliary enterprises net of scholarship allowances of \$11.3 million while grants and contracts decreased \$34.7 million due to decreases in professional supplemental payments from the state and a reduction in funding from the American Recovery and Reinvestment Act of 2009.

Operating expenses totaled \$2.35 billion in fiscal year 2012. Of this amount, \$1.10 billion, excluding depreciation, or 47% was expended for educational and general programs, including instruction, research and public service. Hospital expenses, excluding depreciation, totaled \$823.4 million, (35%) of the total expenses, and clinical operations expenses, excluding depreciation, were \$168.9 million (seven percent). Depreciation amounted to \$122.2 million (five percent). Operating expenses for fiscal year 2012 increased \$148.4 million (seven percent) over fiscal year 2011 primarily due to increases in hospital expenses, excluding depreciation of \$92.4 million (13%), clinical operations expenses, excluding depreciation, of \$25.2 million (18%); education and general programs expenses, excluding depreciation, of \$16.8 million (two percent); and depreciation expense of \$10.4 million (nine percent).

The net loss from operations for the 2012 fiscal year totaled \$363.0 million. Nonoperating and other revenues, net of expenses, totaled \$407.2 million, resulting in an increase in net position of \$44.2 million for the year. Nonoperating revenue included state appropriations of \$297.6 million, which increased \$1.1 million from June 30, 2011 to June 30, 2012.

### **Statement of Cash Flows**

The Statement of Cash Flows details how cash has increased or decreased during the fiscal year ended June 30, 2013, with comparative financial information for the fiscal year ended June 30, 2012. 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 position 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, 2013, 2012 and 2011 follows:

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>CASH PROVIDED (USED) BY:</b>			
Operating activities	\$ (152,097)	\$ (271,163)	\$ (228,807)
Noncapital financing activities	402,433	416,254	449,513
Capital and related financing activities	(127,067)	(253,701)	(255,258)
Investing activities	<u>(19,582)</u>	<u>77,004</u>	<u>(78,944)</u>
Net increase (decrease) in cash and cash equivalents	103,687	(31,606)	(113,496)
<b>Cash and cash equivalents, beginning of year</b>	<u>348,180</u>	<u>379,786</u>	<u>493,282</u>
<b>Cash and cash equivalents, end of year</b>	<u><u>\$ 451,867</u></u>	<u><u>\$ 348,180</u></u>	<u><u>\$ 379,786</u></u>

The University's cash and cash equivalents increased \$103.7 million in fiscal year 2013. Total cash provided by operating and noncapital financing activities was \$250.3 million, an increase of \$105.2 million compared to fiscal year 2012. Total cash used by capital financing activities was \$127.1 million, reflecting both capital funding sources (debt proceeds) and uses (purchases of capital assets and debt service). Total cash used by investing activities was \$19.6 million.

Major sources of cash received from operating activities were student tuition and fees of \$265.1 million; hospital services of \$973.8 million; grants, contracts, and recoveries of facilities and administrative costs of \$330.6 million; and professional clinical service fees of \$224.8 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 \$699.6 million.

Noncapital financing activities include state appropriations from the Commonwealth of \$283.9 million; gifts of \$90.7 million and other noncapital financing receipts of \$27.5 million.

Capital and related financing activities include proceeds of capital debt of \$30.8 million and capital grants and gifts of \$36.2 million. Cash of \$102.5 million was expended for construction and acquisition of capital assets and \$86.0 million was expended for principal and interest payments on debt.

Investing activities include proceeds from sales and maturities of investments of \$741.2 million and interest and dividends on investments of \$15.5 million. Cash of \$776.2 million was used to purchase investments.

**2012 Versus 2011.** Cash balances are lower when comparing fiscal year 2012 to fiscal year 2011. The \$31.6 million net decrease in cash was created from more cash provided by investing activities, offset by less cash provided by noncapital activities and more cash used for operating activities.

## Capital Asset and Debt Administration

### Capital Assets

Capital assets, net of accumulated depreciation, totaled \$1.94 billion at June 30, 2013, a decrease of \$30.8 million. Capital assets as of June 30, 2013, 2012 and 2011, and significant changes in capital assets during the years ended June 30, 2012 and 2013 follow (in millions):

	Balance June 30, 2011	Net Additions (Deletions) FY 11-12	Balance June 30, 2012	Net Additions (Deletions) FY 12-13	Balance June 30, 2013
Land and land improvements	\$ 160	\$ 3	\$ 163	\$ 17	\$ 180
Buildings, fixed equipment and infrastructure	2,158	153	2,311	58	2,369
Equipment, vehicles and capitalized software	625	63	688	22	710
Library materials and art	155	3	158	2	160
Construction in progress	120	(62)	58	(23)	35
Accumulated depreciation	(1,309)	(94)	(1,403)	(107)	(1,510)
Total	<u>\$ 1,909</u>	<u>\$ 66</u>	<u>\$ 1,975</u>	<u>\$ (31)</u>	<u>\$ 1,944</u>

At June 30, 2013, the University had capital construction projects in progress totaling approximately \$292.2 million in scope. Major projects include continuing work on the Softball Complex renovation and Nicholasville Road Flood Mitigation projects, and new projects such as the renovations to Commonwealth Stadium/Nutter Training Facility and the construction of the Academic Science Building. The estimated cost to complete the projects in progress is approximately \$256.5 million.

### Debt

At June 30, 2013, capital debt amounted to \$647.8 million, summarized by trust indenture and type as follows (in millions):

	2013	2012	2011
General Receipts bonds and notes	\$ 479	\$ 500	\$ 491
Consolidated Educational Buildings Revenue Bonds	38	42	83
Capital lease obligations	109	115	134
Notes payable	22	22	24
Total	<u>\$ 648</u>	<u>\$ 679</u>	<u>\$ 732</u>

Debt decreased \$31.6 million during the year primarily due to the principal payments of \$57.1 million for the University's debt obligations and capital lease refunding net decrease of \$445 thousand offset by capital lease additions of \$25.9 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. 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 continues to suffer from fiscal stress related to the economic downturn, a growing pension liability and retirement health benefits, and continued reliance on one-time budget balancing measures. According to the Governor's Blue Ribbon Commission on Tax Reform, Kentucky faces a structural deficit that could reach \$1 billion by 2020. With regard to the short-term, the Commonwealth's fiscal year 2014 structural deficit exceeds \$150 million. The University's state support for fiscal year 2014 is expected to remain at \$284 million. The Kentucky General Assembly will convene in January 2014 to consider and enact the 2014-2016 biennial budget.
- Student demand is expected to remain high in the coming years. Even though tuition rates for fiscal year 2013-14 reflect a three percent increase, the University is expected to enroll the largest, most diverse and one of the best prepared incoming freshmen class in the institution's history. Applications for the Fall 2013 incoming class increased over five percent to 19,800 as compared to the prior fall of 18,800. Preliminary numbers indicate that the fall 2013 entering freshmen class will total 4,702 students – an increase of 55 students, or 1.2%, compared to last fall. The tuition rate increases, the higher percentage of non-resident undergraduate students, and projected enrollment are expected to generate additional operating revenues of \$32.0 million compared to the fiscal year 2012-13 original budget.
- To meet the needs of the University's growing student body; improve the quality of academic programs, scientific research, and creative scholarship; and expand access and ensure affordability, the University sought and received authorization from the Kentucky General Assembly to self-finance three building projects:
  - A \$65 million renovation and expansion of the Gatton College of Business and Economics, which is made possible through the generosity of the University's donors.
  - A new \$100 million Academic Science Building that will accommodate the next generation of scientific learning, research and discovery. The University Department of Intercollegiate Athletics (Athletics) will fund nearly two thirds or \$65 million, of the project cost.
  - A \$110 million renovation of Commonwealth Stadium and Nutter Training and Recruiting Center; financed completely by Athletics.
- As of June 30, 2013, grants and contracts of approximately \$189.0 million, a decrease of approximately \$2.5 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 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 601-bed living-learning community with classrooms and meeting space on the former site of Haggin Field began in Spring 2012. The facilities opened in August 2013. Phase II-A of the housing plan is currently under way 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.
- In June 2013, UK HealthCare received board approval to begin the 8<sup>th</sup> floor fit-up of Pavilion A of the Patient Care Facility. At an estimated cost of \$30 million dollars, the floor will be programmed for cardiovascular patients and will provide state of the art, incremental bed capacity for continued future growth.
- 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 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 POSITION (in thousands)  
JUNE 30, 2013 AND 2012

	2013	2012
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 391,975	\$ 294,063
Notes, loans and accounts receivable, net	229,352	254,101
Investments	6,944	8,408
Inventories and other assets	36,189	35,345
Total current assets	<u>664,460</u>	<u>591,917</u>
<b>Noncurrent Assets</b>		
Restricted cash and cash equivalents	59,892	54,117
Endowment investments	1,054,448	947,383
Other long-term investments	161,574	144,019
Notes, loans and accounts receivable, net	50,478	41,048
Other noncurrent assets	16,299	18,318
Capital assets, net	1,944,122	1,974,953
Total noncurrent assets	<u>3,286,813</u>	<u>3,179,838</u>
Total assets	<u>3,951,273</u>	<u>3,771,755</u>
<b>LIABILITIES AND DEFERRED INFLOWS OF RESOURCES</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	192,661	191,102
Unearned revenue	64,552	62,852
Long-term liabilities - current portion	70,308	75,943
Total current liabilities	<u>327,521</u>	<u>329,897</u>
<b>Noncurrent Liabilities</b>		
Long-term liabilities	757,223	765,471
Total noncurrent liabilities	<u>757,223</u>	<u>765,471</u>
Total liabilities	1,084,744	1,095,368
<b>Deferred Inflows of Resources</b>		
	561	-
Total liabilities and deferred inflows of resources	<u>1,085,305</u>	<u>1,095,368</u>
<b>NET POSITION</b>		
<b>Net investment in capital assets</b>		
	1,295,952	1,299,249
<b>Restricted</b>		
Nonexpendable		
Scholarships and fellowships	131,743	127,819
Research	267,594	261,843
Instruction	76,649	76,517
Academic support	83,741	83,549
Other	7,949	7,984
Total restricted nonexpendable	<u>567,676</u>	<u>557,712</u>
Expendable		
Scholarships and fellowships	57,802	46,172
Research	57,605	36,902
Instruction	44,562	36,138
Academic support	38,889	27,713
Loans	10,531	9,978
Capital projects	77,165	60,032
Debt service	1,830	4,120
Auxiliary	11,763	10,696
Other	14,878	10,406
Total restricted expendable	<u>315,025</u>	<u>242,157</u>
Total restricted	<u>882,701</u>	<u>799,869</u>
<b>Unrestricted</b>		
	<u>687,315</u>	<u>577,269</u>
Total net position	<u>\$ 2,865,968</u>	<u>\$ 2,676,387</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY**  
**A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (in thousands)**  
**FOR THE YEARS ENDED JUNE 30, 2013 AND 2012**

	2013	2012
<b>OPERATING REVENUES</b>		
Student tuition and fees	\$ 364,547	\$ 330,886
Less: Scholarship allowances	(99,254)	(87,522)
Net tuition and fees	265,293	243,364
Federal grants and contracts	165,214	180,198
State and local grants and contracts	87,143	108,494
Nongovernmental grants and contracts	31,021	29,030
Recoveries of facilities and administrative costs	47,862	51,818
Sales and services	57,022	56,064
Federal appropriations	16,890	16,529
County appropriations	19,312	17,457
Professional clinical service fees	222,475	220,633
Hospital services	945,885	906,607
Auxiliary enterprises:		
Housing and dining	57,793	54,386
Less: Scholarship allowances	(7,367)	(6,656)
Net housing and dining	50,426	47,730
Athletics	72,033	69,307
Other auxiliaries	30,547	32,179
Other operating revenues	3,772	2,631
Total operating revenues	2,014,895	1,982,041
<b>OPERATING EXPENSES</b>		
Educational and general:		
Instruction	257,723	269,037
Research	247,691	262,858
Public service	229,946	266,558
Libraries	19,496	20,047
Academic support	85,538	85,827
Student services	34,125	33,100
Institutional support	58,104	61,784
Operations and maintenance of plant	63,202	67,368
Student financial aid	30,251	29,451
Depreciation	69,508	67,402
Total educational and general	1,095,584	1,163,432
Clinical operations (including depreciation of \$1,995 in 2013 and \$1,817 in 2012)	191,659	170,727
Hospital and clinics (including depreciation of \$51,261 in 2013 and \$45,643 in 2012)	891,325	869,064
Auxiliary enterprises:		
Housing and dining (including depreciation of \$5,020 in 2013 and \$3,162 in 2012)	47,543	46,497
Athletics (including depreciation of \$5,282 in 2013 and \$4,195 in 2012)	84,072	75,271
Other auxiliaries	21,103	18,933
Other operating expenses	682	1,102
Total operating expenses	2,331,968	2,345,026
Net loss from operations	(317,073)	(362,985)
<b>NONOPERATING REVENUES (EXPENSES)</b>		
State appropriations	283,869	297,580
Gifts and non-exchange grants	98,418	86,735
Investment income (loss)	104,748	(232)
Interest on capital asset-related debt	(29,244)	(32,151)
Other nonoperating revenues and expenses, net	9,856	7,654
Net nonoperating revenues (expenses)	467,647	359,586
Net income (loss) before other revenues, expenses, gains or losses	150,574	(3,399)
Capital grants and gifts	30,672	40,022
Additions to permanent endowments	10,225	11,581
Other, net	(1,890)	(3,978)
Total other revenues (expenses)	39,007	47,625
<b>INCREASE IN NET POSITION</b>	189,581	44,226
<b>NET POSITION, beginning of year</b>	2,676,387	2,632,161
<b>NET POSITION, end of year</b>	\$ 2,865,968	\$ 2,676,387

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, 2013 AND 2012**

	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Student tuition and fees	\$ 265,136	\$ 243,406
Grants and contracts	281,214	311,444
Recoveries of facilities and administrative costs	49,348	51,104
Sales and services	57,584	54,950
Federal appropriations	14,858	18,164
County appropriations	18,935	18,622
Payments to vendors and contractors	(699,620)	(719,376)
Student financial aid	(30,169)	(29,534)
Salaries, wages and benefits	(1,462,989)	(1,448,810)
Professional clinic service fees	224,818	222,721
Hospital services	973,830	865,793
Auxiliary enterprise receipts	153,741	146,504
Loans issued to students	(17,137)	(18,914)
Collection of loans to students	16,422	17,397
Self insurance receipts	45,035	41,852
Self insurance payments	(43,921)	(45,597)
Other operating receipts (payments), net	818	(889)
Net cash provided (used) by operating activities	<u>(152,097)</u>	<u>(271,163)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
State appropriations	283,869	297,580
Gifts and grants received for other than capital purposes:		
Gifts received for endowment purposes	10,225	11,581
Gifts received for other purposes	80,516	90,473
Agency and loan program receipts	210,958	198,305
Agency and loan program payments	(210,594)	(197,994)
Other noncapital financing receipts (payments), net	27,459	16,309
Net cash provided (used) by noncapital financing activities	<u>402,433</u>	<u>416,254</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Capital grants and gifts	36,249	35,051
Purchases of capital assets	(102,520)	(201,205)
Proceeds from capital debt	30,832	38,611
Payments to refunding bond agents	(5,633)	(33,115)
Principal paid on capital debt and leases	(56,419)	(57,476)
Interest paid on capital debt and leases	(29,535)	(33,270)
Other capital and related financing receipts (payments), net	(41)	(2,297)
Net cash provided (used) by capital and related financing activities	<u>(127,067)</u>	<u>(253,701)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales and maturities of investments	741,159	571,005
Interest and dividends on investments	15,476	22,696
Purchase of investments	(776,217)	(516,697)
Net cash provided (used) by investing activities	<u>(19,582)</u>	<u>77,004</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<u>103,687</u>	<u>(31,606)</u>
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>348,180</u>	<u>379,786</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 451,867</u>	<u>\$ 348,180</u>
<b>Reconciliation of net loss from operations</b>		
<b>to net cash used by operating activities:</b>		
Net loss from operations	\$ (317,073)	\$ (362,985)
Adjustments to reconcile net loss from operations		
to net cash used by operating activities:		
Depreciation expense	133,066	122,219
Change in assets and liabilities:		
Notes, loans and accounts receivable, net	26,580	(42,651)
Inventories and other assets	1,442	372
Accounts payable and accrued liabilities	1,967	19,937
Unearned revenue	1,676	(5,773)
Long-term liabilities	245	(2,282)
<b>Net cash provided (used) by operating activities</b>	<u>\$ (152,097)</u>	<u>\$ (271,163)</u>

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 (the Commonwealth) 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 and No. 61 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; 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 affiliates are presented as blended component units since University management has operational responsibility for each affiliated corporation. 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. KMSF is included within the University reporting entity as blended component unit as KMSF provides its services entirely to the University. The financial statements also include the operations of the UK HealthCare Hospital System (the System) and the Department of Intercollegiate Athletics (Athletics), organizational units of the University. The separate financial statements for the above entities can be found at: [www.uky.edu/evpfa/controller/finst](http://www.uky.edu/evpfa/controller/finst).

**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 position categories:

- Net investment in capital assets: 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 position 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 position 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 position whose use by the University is not subject to externally imposed stipulations. Unrestricted net position 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, deferred outflows of resources, liabilities, deferred inflows of resources, net position, revenues, expenses, changes in net position and cash flows.

During the year ended June 30, 2013 the University adopted GASB No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*.

The objective of GASB No. 63 is to provide guidance for reporting deferred outflows of resources, deferred inflows of resources and net position in a statement of financial position and related disclosures. GASB No. 63 has been applied retrospectively, by reclassifying certain 2012 financial statement line items to conform with the presentation requirements of the standard.

In addition to assets, GASB No. 63 requires the presentation of a separate financial statement element, deferred outflows of resources, which represents a consumption of net position that applies to a future period. The University has no deferred outflows of resources for fiscal 2013.

In addition to liabilities, GASB No. 63 requires the presentation of a separate financial statement element, deferred inflows of resources, which represents an acquisition of net position that applies to a future period. The University has deferred inflows of resources of \$561,000 for fiscal 2013.

The deferred inflows of resources represent the fair value of a derivative, which is defined as a hedging instrument, that provides a specified rate of return on certain debt service instruments.

### **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 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 Kentucky Uniform Prudent Management of Institutional Funds Act (UPMIFA), as adopted by the Commonwealth 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 has made expenditure decisions in accordance with UPMIFA and donor gift agreements. UPMIFA prescribes guidelines for expenditure of a donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations) and focuses on the entirety of a donor-restricted endowment fund, that is, both the original gift amount(s) and net appreciation. In accordance with the standard of prudence prescribed by UPMIFA and consistent with industry standards, the University has adopted a spending policy whose long-term objective is to maintain the purchasing power of each endowment and provide a predictable and sustainable level of income to support current operations.



For the years ended June 30, 2013 and 2012, the University's endowment standard spending rule provided for annual distributions of 4.25% of the 60 month moving average market value of fund units. 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<sup>st</sup>, which is the measurement date for calculating spending distributions for the following fiscal year. Additionally, for the years ended June 30, 2013 and 2012, the University's annual endowment management fee was 0.25%, however endowments whose market value was less than the contributed value as of December 31<sup>st</sup> were exempt from the management fee in the subsequent fiscal year.

The components of the University's spending policy distribution and management fee for the years ended June 30, 2013 and 2012 are as follows (in thousands):

	2013	2012
Gross spending policy distribution	\$ 36,289	\$ 35,118
Reinvested spending policy distribution	(16,216)	(15,643)
Net spending policy distribution	\$ 20,073	\$ 19,475
Management fee	\$ 1,949	\$ 976

For future years the University has established a "hybrid" spending policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending will be calculated by taking a weighted average comprising 60% of the prior year's spending, adjusted for inflation, and 40% of the amount that results when the target annual spending rate of four percent is applied to the average market value of the endowment over the preceding 36 months. The spending amount determined by the formula will be constrained so that the calculated rate is at least three percent, and not more than six percent, of the current endowment market value. The hybrid spending policy will be phased in over two years. The year ending June 30, 2014 will serve as a transition year to the new policy and spending will be based on four percent of the average market value for the preceding 60 months. The hybrid policy will be fully implemented in the year ending June 30, 2015.

Additionally, for fiscal years ending June 30, 2014 and thereafter, spending and management fee withdrawals will be suspended on all endowments with a market value less than the contributed value by more than 20% at December 31<sup>st</sup> of the prior year. Endowments with a market value less than the contributed value by more than 10% will undergo a formal review to determine the appropriate level of spending in accordance with various factors set forth in UPMIFA.

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 Position. 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, 2013 and 2012, as adjusted by cash receipts, cash disbursements, and securities distributions through June 30, 2013 and 2012, at a total estimated fair value of \$114,298,000 and \$90,486,000, respectively. Other alternative investments are carried at estimated fair values as of December 31, 2012 and 2011, at a total estimated value of \$1,350,000 and \$1,330,000, 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 \$298,736,000 and \$274,618,000 at June 30, 2013 and 2012. The University believes that the total carrying amount of its alternative investments valued at \$458,682,000 and \$408,415,000 at June 30, 2013 and 2012 is a reasonable estimate of fair value. The University's outstanding commitment to alternative investments is \$116,906,000 and \$141,265,000 as of June 30, 2013 and 2012, 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.

Unearned Revenue. Unearned revenue consists primarily of amounts received from grant and contract sponsors that have not yet been earned under the terms of the agreement. Unearned 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. Unearned 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, 2013 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 position 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 24% and 23%, respectively, of the System's net patient services revenues before the provision for doubtful accounts for the year ended June 30, 2013 and approximately 25% and 23%, respectively for the year ended June 30, 2012. 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 physicians and hospitals that demonstrate meaningful use of certified electronic health records technology. Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs is contingent on the System and KMSF 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 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 2013, the System was in the second year under the Medicare programs but did not attest to completion of the second phase and recorded no revenue. In fiscal year 2012, the System recorded \$2.0 million which was included in hospital services within operating revenues in the Statement of Revenues, Expenses, and Changes in Net Position. KMSF recorded \$124,000 revenue under the Medicare program. The revenue was included in other operating revenues in the Statement of Revenues, Expenses and Changes in Net Position.

In fiscal year 2013, the System completed the second-year requirements under the Medicaid program and recorded revenue of approximately \$2.2 million, which is included in hospital services within operating revenues in the Statement of Revenues, Expenses, and Changes in Net Position. KMSF applied for and received approximately \$1.9 million and \$700,000 under the Medicaid program in fiscal year 2013 and 2012. The revenue was included in other operating revenues. In fiscal year 2011, the System recorded \$2.9 million in revenue after completing first year requirements.

Income Taxes. The University is an agency and instrumentality of the Commonwealth, 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 Position, 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 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 2013 and 2012, departmental research in nonsponsored accounts of \$63,400,000 and \$67,382,000, respectively, was recorded as research expense in the Statement of Revenues, Expenses and Changes in Net Position.

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. In April 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. With the exception of prepaid insurance costs, costs related to the issuance of debt will no longer be recorded as a deferred charge and amortized over the life of the debt, but instead will be recognized as an expense in the period incurred. Accounting changes to comply with the standard will be applied retroactively by restating financial statements for all periods presented. The adoption of GASB No. 65 will require classification of certain items and a change in the recognition of items previously reported as assets and liabilities, beginning with the fiscal year ending June 30, 2014.

GASB has also issued certain statements which are applicable to the University for fiscal years ending after June 30, 2013. The University does not expect the adoption of GASB No. 66-70 to have a material effect on its financial statements.

Reclassifications. Certain reclassifications have been made to the fiscal year 2012 financial statements to conform to the fiscal year 2013 financial statement presentation. Such reclassifications had no effect on the change in net position.

## 2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2013 and 2012 is as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Deposits with banks and the Commonwealth of Kentucky	\$ 81,513	\$ 50,506
U.S. Treasury fixed income securities	11,165	12,171
Government agency fixed income securities	52,035	29,527
State and municipal fixed income securities	7,418	7,391
Common and preferred stocks	51,862	42,382
Pooled equity funds	407,828	361,994
Pooled private equity funds	88,064	71,791
Pooled absolute return funds	211,085	185,231
Pooled real return funds	88,572	89,387
Pooled real estate funds	70,961	62,006
Pooled fixed income funds	365,042	308,258
Corporate fixed income securities	25,157	28,913
Guaranteed investment contracts	1,645	762
Repurchase agreements	84,141	151,159
Certificates of deposit	26,703	27,450
Cash and cash equivalents	101,490	18,450
Other	152	612
Total	<u>\$ 1,674,833</u>	<u>\$ 1,447,990</u>

	<u>2013</u>	<u>2012</u>
Statement of Net Position classification		
Cash and cash equivalents	\$ 391,975	\$ 294,063
Current investments	6,944	8,408
Restricted cash and cash equivalents	59,892	54,117
Endowment investments	1,054,448	947,383
Other long-term investments	161,574	144,019
Total	<u>\$ 1,674,833</u>	<u>\$ 1,447,990</u>

Alternative investments totaling \$458,682,000 and \$408,415,000 as of June 30, 2013 and 2012, respectively, 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 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 and other financial institutions.
- Bond revenue fund investments held by the Treasurer of the Commonwealth as required by the University's bond trust indentures and invested in pooled fixed income funds managed by the Commonwealth.
- 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.
- 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 Position.

**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 (FDIC). The University's deposits are insured up to \$250,000 at each FDIC insured institution. Credit risk on deposits in excess of FDIC coverage and 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 is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. Treasury or agency securities, pledged in the name of the Commonwealth. 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 10%); and state and local property tax certificates of delinquency secured by interests in real estate.
- Short-term investments managed by the University are limited to 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%; 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, 2013, and 2012, respectively, the credit quality of the University's fixed income investments is as follows (in thousands):

	2013							Total
	S&P/Moody's Credit Ratings							
	AAA/Aaa	AA/Aa	A	BBB/Baa	B	Not rated	Rating Not Applicable	
U.S. Treasury fixed income	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 11,165	\$ 11,165
Government agency fixed income	-	52,035	-	-	-	-	-	52,035
State and municipal fixed income	-	277	7,141	-	-	-	-	7,418
Pooled fixed income	-	-	-	-	-	365,042	-	365,042
Corporate fixed income	-	832	16,253	2,681	5,391	-	-	25,157
Guaranteed investment contracts	-	40	-	-	-	1,605	-	1,645
Repurchase agreements	-	-	-	-	-	84,141	-	84,141
Certificates of deposit	-	-	-	-	-	26,703	-	26,703
Cash and cash equivalents	82,826	-	-	-	-	18,664	-	101,490
<b>Total fixed income investments</b>	<b>\$ 82,826</b>	<b>\$ 53,184</b>	<b>\$ 23,394</b>	<b>\$ 2,681</b>	<b>\$ 5,391</b>	<b>\$ 496,155</b>	<b>\$ 11,165</b>	<b>\$ 674,796</b>

	2012							Total
	S&P/Moody's Credit Ratings							
	AAA/Aaa	AA/Aa	A	BBB/Baa	B	Not rated	Rating Not Applicable	
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
<b>Total fixed income investments</b>	<b>\$ 30,218</b>	<b>\$ 7,498</b>	<b>\$ 1,497</b>	<b>\$ 27,309</b>	<b>\$ -</b>	<b>\$ 505,388</b>	<b>\$ 12,171</b>	<b>\$ 584,081</b>

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

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

- Overnight deposits and repurchase agreements are not exposed to custodial credit risk other than repurchase agreements with the Commonwealth, 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, 2013 and 2012, respectively, the following University deposit and investment balances held in the name of the Commonwealth included in the above significant investment types, were exposed to custodial credit risk as follows (in thousands):

	2013				
	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	\$ 91,000	\$ -	\$ -	\$ -	\$ 91,000
Uninsured, not registered in the name of the University and held by the counterparty but not in the University's name	-	179,904	60,000	25,823	265,727
<b>Total</b>	<b>\$ 91,000</b>	<b>\$ 179,904</b>	<b>\$ 60,000</b>	<b>\$ 25,823</b>	<b>\$ 356,727</b>

	2012				
	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
<b>Total</b>	<b>\$ 168,000</b>	<b>\$ 91,747</b>	<b>\$ 60,303</b>	<b>\$ 55,859</b>	<b>\$ 375,909</b>

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

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

- Overnight 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% 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%.
- 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, 2013 and 2012, 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 two years of the duration of the Barclays Aggregate Bond Index.

For June 30, 2013, below is the maturity distribution of the University's fixed income investments (in thousands):

Investment Type	2013						Total
	Maturities in Years					Managed based on duration	
	Less than 1	1-3	3-5	5-10	Greater than 10		
U.S. Treasury fixed income	\$ 2,223	\$ 10	\$ 52	\$ 45	\$ -	\$ 8,835	\$ 11,165
Government agency fixed income	-	-	24,660	17,786	-	9,589	52,035
State and municipal fixed income	-	4,691	2,449	278	-	-	7,418
Pooled fixed income	-	-	-	-	-	365,042	365,042
Corporate fixed income	-	547	200	261	-	24,149	25,157
Guaranteed investment contracts	-	-	145	39	1,461	-	1,645
Repurchase agreements	79,171	1,013	-	3,957	-	-	84,141
Certificates of deposit	26,703	-	-	-	-	-	26,703
Cash and cash equivalents	101,490	-	-	-	-	-	101,490
<b>Total fixed income investments</b>	<b>\$ 209,587</b>	<b>\$ 6,261</b>	<b>\$ 27,506</b>	<b>\$ 22,366</b>	<b>\$ 1,461</b>	<b>\$ 407,615</b>	<b>\$ 674,796</b>

For June 30, 2012, below is the maturity distribution of the University's fixed income investments (in thousands):

Investment Type	2012						Total
	Maturities in Years					Managed based on duration	
	Less than 1	1-3	3-5	5-10	Greater than 10		
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
<b>Total fixed income investments</b>	<b>\$ 200,032</b>	<b>\$ 1,578</b>	<b>\$ 27,330</b>	<b>\$ 898</b>	<b>\$ 19</b>	<b>\$ 354,224</b>	<b>\$ 584,081</b>

At June 30, 2013 and 2012, the University had the following investments managed based on duration (in thousands):

Investment Type	2013		2012	
	Fair Value	Modified Duration (Years)	Fair Value	Modified Duration (Years)
U.S. Treasury fixed income securities				
Pooled endowment fund	\$ 8,835	7.8	\$ 9,692	7.4
Government agency fixed income securities				
Pooled endowment fund	9,589	4.3	8,965	4.2
Pooled fixed income funds				
Pooled endowment fund	97,061	3.5	98,191	2.4
Other endowment investments	2,139	5.5	2,091	5.3
Commonwealth of Kentucky short-term pool	196,044	0.1	144,579	0.2
Commonwealth of Kentucky intermediate pool	69,683	2.0	63,330	1.2
457 Deferred Compensation Plan	63	5.6	32	5.1
Kentucky Technology, Inc.	52	2.1	35	4.5
Corporate fixed income securities				
Pooled endowment fund	24,149	3.8	27,309	3.7
<b>Total</b>	<b>\$ 407,615</b>		<b>\$ 354,224</b>	

**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, 2013 and 2012, the following investments were subject to foreign currency risk (in thousands):

<u>Endowment Investment</u>	<u>Fair Value</u>	
	<u>2013</u>	<u>2012</u>
Common stock	\$ 43,060	\$ 33,155
Pooled private equity funds	<u>8,034</u>	<u>7,262</u>
Total	<u>\$ 51,094</u>	<u>\$ 40,417</u>

**Derivative Financial Instruments.** The University has entered into a forward delivery purchase agreement (the Forward Delivery Agreement). The Forward Delivery Agreement requires the counterparty to deposit U.S. Treasury securities into the University's debt service reserve trust account and provides the University with a guaranteed rate of return. The securities that are deposited into the Consolidated Educational Building Revenue Bonds (CEBRB) debt service reserve trust accounts are required to mature prior to the scheduled debt service payment dates.

The Forward Delivery Agreement allows the University to earn a guaranteed fixed rate of return over the life of the investment. This agreement was utilized by the University to earn a rate of return in excess of a rate that would otherwise be feasible by investing in securities with a shorter term.

The date of the Forward Delivery Agreement is June 16, 2004, with a termination date of May 1, 2024. The scheduled reserve amount varies throughout the term and was \$2.2 million as of June 30, 2013. The guaranteed rate is 4.73% and the fair market value of the Forward Delivery Agreement is \$561,000 as of June 30, 2013.

The fair value of the Forward Delivery Agreement is based on the value of the future discounted cash flow expected to be received over the life of the agreement. The fair value of the Forward Delivery Agreement is classified as a noncurrent asset in the Statement of Net Position. As the Forward Delivery Agreement is an effective hedging instrument, the offsetting balance is reflected as deferred inflows of resources in the Statement of Net Position.

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

Notes, loans and accounts receivable as of June 30, 2013 and 2012 follows (in thousands):

	2013		
	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Hospital patient accounts	\$ 153,344	\$ (34,750)	\$ 118,594
KMSF patient accounts	28,107	(5,676)	22,431
Dentistry patient accounts	2,773	(797)	1,976
Student loans	27,924	(2,467)	25,457
Reimbursement receivable - grants and contracts	30,268	(575)	29,693
Reimbursement receivable - federal appropriations	2,159	-	2,159
Pledges receivable	55,484	(18,582)	36,902
Accrued interest receivable	2,495	-	2,495
Student receivables	20,167	(11,215)	8,952
Other	31,171	-	31,171
Total	<u>\$ 353,892</u>	<u>\$ (74,062)</u>	<u>\$ 279,830</u>
Current portion			\$ 229,352
Noncurrent portion			<u>50,478</u>
Total			<u>\$ 279,830</u>
	2012		
	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
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	<u>\$ 365,346</u>	<u>\$ (70,197)</u>	<u>\$ 295,149</u>
Current portion			\$ 254,101
Noncurrent portion			<u>41,048</u>
Total			<u>\$ 295,149</u>

#### 4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2013 and capital asset activity for the year ended June 30, 2013 are summarized below (in thousands):

	June 30, 2012	Additions	Deletions	June 30, 2013
Land	\$ 63,666	\$ 7,814	\$ -	\$ 71,480
Land improvements - nonexhaustible	37,447	3,045	-	40,492
Land improvements - exhaustible	61,842	7,338	708	68,472
Buildings	2,135,650	58,106	9,460	2,184,296
Fixed equipment - communications	83,939	6,902	66	90,775
Infrastructure	91,507	2,090	36	93,561
Equipment	541,492	32,022	20,349	553,165
Vehicles	20,631	1,398	1,345	20,684
Library materials	140,377	2,339	140	142,576
Nondepreciable library materials	6,601	17	-	6,618
Capitalized software	126,366	9,516	58	135,824
Art	10,991	215	58	11,148
Construction in progress	57,420	28,069	50,727	34,762
	<u>3,377,929</u>	<u>158,871</u>	<u>82,947</u>	<u>3,453,853</u>
<u>Accumulated Depreciation</u>				
Land improvements - exhaustible	50,992	2,425	708	52,709
Buildings	722,365	57,646	7,460	772,551
Fixed equipment - communications	47,536	5,912	66	53,382
Infrastructure	25,858	3,719	16	29,561
Equipment	357,167	47,114	16,894	387,387
Vehicles	16,926	1,546	1,089	17,383
Library materials	128,167	3,329	-	131,496
Capitalized software	53,965	11,375	78	65,262
	<u>1,402,976</u>	<u>133,066</u>	<u>26,311</u>	<u>1,509,731</u>
Capital assets, net	<u>\$ 1,974,953</u>	<u>\$ 25,805</u>	<u>\$ 56,636</u>	<u>\$ 1,944,122</u>

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
	<u>3,218,601</u>	<u>289,568</u>	<u>130,240</u>	<u>3,377,929</u>
<u>Accumulated Depreciation</u>				
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
	<u>1,309,430</u>	<u>122,219</u>	<u>28,673</u>	<u>1,402,976</u>
Capital assets, net	<u>\$ 1,909,171</u>	<u>\$ 167,349</u>	<u>\$ 101,567</u>	<u>\$ 1,974,953</u>

At June 30, 2013, the University had construction projects in progress totaling approximately \$292.2 million in scope. The estimated cost to complete these projects was approximately \$256.5 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.

Interest costs incurred during construction, net of related investment income, are capitalized. Total interest capitalized was \$17,000 for 2013 and \$562,000 for 2012.

During fiscal year 2013 and 2012, the University utilized capital leases to acquire various items of equipment. As of June 30, 2013 and 2012, the net book value of land, buildings, equipment and software acquired through capital lease included in the above schedules totaled \$147.8 million and \$160.1 million, respectively.

During fiscal year 2013, five student housing buildings were demolished with an original cost of \$8.3 million and accumulated depreciation of \$7.2 million, for a total net book value written off of \$1.1 million. In addition, 14 student housing buildings were scheduled for demolition in subsequent fiscal years and have been recorded as impaired assets. Accordingly, a portion of the net book value of each building was written off in this fiscal year with the remainder to be written off in subsequent years. The total original cost of impaired assets is \$28.7 million with accumulated depreciation of \$21.1 million, for a total net book value written off in fiscal year 2013 of \$3.1 million.

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

	<u>2013</u>	<u>2012</u>
Capital lease additions	\$ 766	\$ 2,113
Gifts of capital assets	3,012	3,817
Capital asset additions in accounts payable	8,942	9,944
Capitalized interest, net of investment income	17	562
Amortized bond discount, premium and cost of issuance	759	713
Capital asset disposal, net	3,148	4,917
Capital asset trade in	426	4,337
Total	<u>\$ 17,070</u>	<u>\$ 26,403</u>

## 5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2013 and 2012 follow (in thousands):

	<u>2013</u>	<u>2012</u>
Payable to vendors and contractors	\$ 90,040	\$ 87,174
Accrued expenses, including vacation and sick leave	62,804	58,517
Employee withholdings and deposits payable to third parties	39,817	45,411
Total	<u>\$ 192,661</u>	<u>\$ 191,102</u>

## 6. UNEARNED REVENUE

Unearned revenue as of June 30, 2013 and 2012 follows (in thousands):

	<u>2013</u>	<u>2012</u>
Unearned summer school revenue	\$ 7,330	\$ 7,249
Unearned hospital revenue	6,928	6,583
Unearned grants and contracts revenue	29,509	30,837
Prepaid athletic ticket sales	13,581	11,644
Other	7,204	6,539
Total	<u>\$ 64,552</u>	<u>\$ 62,852</u>

## 7. LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2013 and long-term liability activity for the year ended June 30, 2013 are summarized below (in thousands):

	June 30, 2012	Additions	Reductions	June 30, 2013	Current Portion	Non-Current Portion
<u>Bonds, notes and capital leases</u>						
General Receipts notes	\$ 294,530	\$ -	\$ 14,355	\$ 280,175	\$ 14,995	\$ 265,180
General Receipts bonds	205,090	-	5,795	199,295	5,770	193,525
Educational buildings bonds	42,400	-	4,440	37,960	4,610	33,350
Capital leases and other long-term obligations	114,824	30,836	37,019	108,641	24,262	84,379
Notes payable	22,578	104	963	21,719	1,055	20,664
Total bonds, notes and capital leases	679,422	30,940	62,572	647,790	50,692	597,098
<u>Other liabilities</u>						
Medical malpractice	25,774	3,352	2,780	26,346	4,114	22,232
Long-term disability	2	4	-	6	6	-
Annuities payable	4,800	459	471	4,788	516	4,272
Health insurance	5,900	35,222	35,084	6,038	6,038	-
Automobile and property self insurance	316	1,018	920	414	414	-
Retiree health benefits trust	57,722	17,640	-	75,362	-	75,362
Federal loan programs	21,122	387	517	20,992	-	20,992
Workers compensation	21,045	3,171	4,451	19,765	4,928	14,837
Compensated absences	7,655	69	90	7,634	585	7,049
Arbitrage rebate	375	-	370	5	-	5
Unamortized bond premium	12,536	620	1,038	12,118	1,038	11,080
Unemployment compensation	670	732	773	629	629	-
Other	4,075	4,537	2,968	5,644	1,348	4,296
Total other liabilities	161,992	67,211	49,462	179,741	19,616	160,125
Total	\$ 841,414	\$ 98,151	\$ 112,034	\$ 827,531	\$ 70,308	\$ 757,223



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

	June 30, 2011	Additions	Reductions	June 30, 2012	Current Portion	Non-Current Portion
<u>Bonds, notes and capital leases</u>						
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
CEBRB	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	<u>731,950</u>	<u>37,233</u>	<u>89,761</u>	<u>679,422</u>	<u>57,672</u>	<u>621,750</u>
<u>Other liabilities</u>						
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	<u>151,426</u>	<u>62,277</u>	<u>51,711</u>	<u>161,992</u>	<u>18,271</u>	<u>143,721</u>
Total	<u>\$ 883,376</u>	<u>\$ 99,510</u>	<u>\$ 141,472</u>	<u>\$ 841,414</u>	<u>\$ 75,943</u>	<u>\$ 765,471</u>

Annuities payable consists of the present value of future payments due under charitable remainder annuity trusts, charitable remainder unitrusts, lead trusts, irrevocable trusts and charitable gift annuities, discounted at five percent to 10.8%.

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 CEHRB in the original amount of \$621,070,000 dated Oct 1, 2003 through June 26, 2012, which bear interest at 1.50% to 4.66%. 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 1.39% to 4.45%.

The indenture agreements require that certain funds be established with the trustee and with the Commonwealth. In addition, CEHRB bonds require a debt service reserve equal to the highest annual aggregate debt service payment due during the remaining lives of the bonds. Currently this amount is \$7,168,000.

On December 4, 2012, the University entered into two lease agreements. State Property and Building Commission (SPBC) 102A – Rural Health has an original amount of \$3,630,000 with a net interest cost of 2.13% and fully refunded SPBC 80A – Rural Health. SPBC 102B – Stadium Expansion has an original amount of \$1,440,000 with a net interest cost of 2.13% and partially refunded SPBC 80A – Stadium Expansion. These new lease agreements will reduce the University's total debt service payments by \$748,000 over the next 12

years, representing an economic gain (difference between the present value of the debt service payments on the old and the new leases) of approximately \$679,000.

In prior fiscal years, certain General Receipts Bonds Series were issued as Build America Bonds (BAB) as authorized under the American Recovery and Reinvestment Act of 2009 and as Qualified Energy Conservation Bonds (QECCB) as authorized under the Recovery Act and the Hiring Incentive to Restore Employment Act of 2010. The University will receive an annual cash subsidy from the U.S. Treasury equal to 35% (BAB) and 80% (QECCB) of the interest payable on the bonds. The subsidy, which was approximately \$2.4 million during fiscal year 2013, is included in gifts and non-exchange grants in the Statements of Revenues, Expenses and Changes in Net Position. The subsidy payment is contingent on federal regulations and may be subject to change. On March 1, 2013, the President signed an executive order reducing the budgetary authority in accounts subject to sequestration. As a result, the BAB and QECCB subsidy is expected to be reduced to approximately 32% and 73%, respectively.

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, 2013, are as follows (in thousands):

	Principal	Interest	Total
2014	\$ 50,692	\$ 28,149	\$ 78,841
2015	46,717	26,368	73,085
2016	41,451	24,713	66,164
2017	59,068	22,904	81,972
2018	41,562	20,661	62,223
2019-2023	185,396	78,156	263,552
2024-2028	159,179	36,351	195,530
2029-2033	24,010	14,623	38,633
2034-2038	27,295	7,545	34,840
2039-2040	12,420	714	13,134
Total	<u>\$ 647,790</u>	<u>\$ 260,184</u>	<u>\$ 907,974</u>

At June 30, 2013, assets with a fair market value of approximately \$4,323,000 have been placed on deposit with trustees to totally defease bonds with a par amount of \$4,065,000. The liability for these fully defeased bonds is not included in the financial statements.

## 8. COMPONENTS OF RESTRICTED EXPENDABLE NET POSITION

Restricted expendable net position 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, 2013 and 2012 restricted expendable net position is composed of the following (in thousands):

	2013	2012
Appreciation on permanent endowments	\$ 87,372	\$ 38,637
Term endowments	7,417	6,209
Quasi-endowments initially funded with restricted assets	45,591	40,560
Funds restricted for capital projects and debt service	78,995	64,152
Funds restricted for noncapital purposes	85,119	82,621
Loan funds (primarily University funds required for federal match)	10,531	9,978
Total	<u>\$ 315,025</u>	<u>\$ 242,157</u>

## 9. DESIGNATIONS OF UNRESTRICTED NET POSITION

Unrestricted net position is 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 position as of June 30, 2013 and 2012 are as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Working capital requirements	\$ 30,570	\$ 35,130
Budget appropriations for future year fiscal operations	156,034	125,007
Designated for capital projects	46,725	43,696
Designated for renewal and replacement of capital assets	24,395	19,380
Hospital System	338,349	260,108
Affiliated corporations and component units	91,242	93,948
Total	<u>\$ 687,315</u>	<u>\$ 577,269</u>

## 10. PLEDGED REVENUES

Pledged revenue for 2013 and 2012 as defined by General Receipts Trust Indenture, is as follows (in thousands):

	<u>2013</u>	<u>2012</u>
Student tuition and fees	\$ 265,293	\$ 243,364
Nongovernmental grants and contracts	701	985
Recoveries of facilities and administrative costs	47,755	51,818
Sales and services	41,139	40,741
Hospital services	945,885	906,607
Auxiliary enterprises - housing and dining	50,426	47,730
Auxiliary enterprises - athletics	72,033	-
Auxiliary enterprises - other	30,547	32,179
Other operating revenue	989	976
State appropriations	283,869	297,580
Gifts and grants	5,015	5,012
Investment income	2,704	2,441
Total	<u>\$ 1,746,356</u>	<u>\$ 1,629,433</u>

The University has substantially pledged all of the unrestricted operating and nonoperating revenues to repay the General Receipts bonds and notes issued during 2005 to 2012. Proceeds from the bonds and notes provided funding for new construction and energy conservation projects. In addition, it provided funding for refunding of all Consolidated Housing and Dining System Revenue Bonds, refunding of Lexington-Fayette Urban County Government bond, and partial refunding of CEBRB and partial refunding of the SPBC project notes. The bonds are payable from unrestricted operating and nonoperating revenues and are payable through 2039. Annual principal and interest payments on bonds are expected to require less than three percent of pledged revenue. The total principal and interest remaining to be paid on the bonds is \$711,626,000 and \$754,778,000 in 2013 and 2012, respectively. Principal and interest paid for 2013 and 2012 were \$43,152,000 and \$39,778,000, respectively.

## 11. INVESTMENT INCOME

Components of investment income (loss) for the years ended June 30, 2013 and 2012 are as follows (in thousands):

	2013	2012
Interest and dividends earned on endowment investments	\$ 16,463	\$ 16,923
Realized and unrealized gains and losses on endowment investments	85,352	(22,897)
Interest and dividends on cash and non-endowment investments	2,315	2,688
Realized and unrealized gains and losses on non-endowment investments	(1,024)	1,498
Investment income from external trusts	1,642	1,556
Total	\$ 104,748	\$ (232)

## 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, 2013 and 2012, the University received income from these trusts of approximately \$1,642,000 and \$1,556,000, respectively. The market value of the external trust assets as of June 30, 2013 and 2012 was approximately \$53,637,000 and \$49,652,000, 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, 2013 and 2012, respectively, pledges are expected to be collected primarily over the next ten years, as follows (in thousands):

	2013	2012
Operating purposes	\$ 15,508	\$ 10,950
Capital projects	44,208	50,947
Total	59,716	61,897
Less discounts and allowances	(22,814)	(33,538)
Total	\$ 36,902	\$ 28,359

In accordance with GASB 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, 2013 and 2012, the University recorded the discounted value of operating and capital pledges using a rate of two percent and three percent, respectively.

Deferred gifts through insurance, known bequests and irrevocable trusts in which the University has a remainder interest are estimated to be approximately \$115,626,000 and \$106,247,000 at June 30, 2013 and 2012, respectively. The University records these amounts as revenue when the cash is received.

#### 14. GRANTS AND CONTRACTS AWARDED

At June 30, 2013 and 2012, grants and contracts of approximately \$189,043,000 and \$191,499,000, respectively, 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 10% 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 2013 and 2012 were approximately \$86,016,000 and \$86,586,000, respectively. Employees contributed approximately \$42,628,000 in 2013 and \$42,853,000 in 2012. The University's total payroll costs were approximately \$1,113,818,000 and \$1,107,769,000, respectively, for the years ended June 30, 2013 and 2012. The payroll for employees covered by the retirement plan was approximately \$857,682,000 and \$866,163,000 for the years ended 2013 and 2012, respectively.

Regular full-time KMSF employees become eligible to participate in a defined contribution plan upon completion of 90 days of service and attainment of age 21. KMSF contributes 10% of the employee's earnings and employees are non-contributing. KMSF contributions for 2013 and 2012 were approximately \$800,000 and \$757,000, respectively. The total payroll costs for employees covered by the defined contribution plan were approximately \$8,000,000 and \$7,570,000 for the years ended June 30, 2013 and 2012, respectively. Participants become vested in the plan according to years of service, with 100% vesting at three years or more.

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, 2013 and 2012.

The Legislature of the Commonwealth 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 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 \$1,741,000 and \$1,943,000 for the years ended June 30, 2013 and 2012, 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% 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% 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% of the "true retiree" cost of the post-65 medical plan. For fiscal year 2013, the University contributed \$20.5 million to the plan. Plan members receiving benefits contributed 30.7% of the premium costs, an average for combined single and family coverage. In fiscal year 2013, total member contributions were approximately \$4.6 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 No. 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 30 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 \$20.4 million is 3.9% 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 2013 (in thousands):

Annual required contribution	\$ 20,392
Contributions made	(20,475)
Increase in net OPEB obligation/(asset)	<u>(83)</u>
Net OPEB obligation/(asset) - Beginning of year	<u>(157)</u>
Net OPEB obligation/(asset) - End of year	<u><u>\$ (240)</u></u>

The University's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for fiscal year 2013, 2012 and 2011, were as follows (in thousands):

Fiscal Year Ended	Annual OPEB cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation/(Asset)
6/30/2011	\$ 23,999	103.6%	\$ (508)
6/30/2012	\$ 19,798	98.2%	\$ (157)
6/30/2013	\$ 20,392	100.4%	\$ (240)

As of July 1, 2013, the actuarial accrued liability (AAL) for benefits was \$252.9 million, with an actuarial value of assets of \$75.4 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$177.5 million. The covered payroll (annual payroll of active employees covered by the plan) was \$526.1 million and the ratio of the UAAL to the covered payroll was 33.7% at June 30, 2013. 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, 2013, net trust fund assets totaled \$75.4 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 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 2012 was 25 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% 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% of their basic salary for the first six months and 60% 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 10% of pre-disability salary per year for applications filed on or after October 1, 2006 and 15% 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 No. 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 30 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 \$2.0 million is 0.3% 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 2013 (in thousands):

Annual required contribution	\$ 2,012
Contributions made	(2,008)
Increase in net OPEB obligation/(asset)	<u>4</u>
Net OPEB obligation/(asset) - Beginning of year	<u>2</u>
Net OPEB obligation/(asset) - End of year	<u><u>\$ 6</u></u>



The University's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for fiscal year 2013, 2012 and 2011 were as follows (in thousands):

Fiscal Year Ended	Annual OPEB cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation/(Asset)
6/30/2011	\$ 2,842	99.7%	\$ 410
6/30/2012	\$ 1,953	120.9%	\$ 2
6/30/2013	\$ 2,012	99.8%	\$ 6

As of July 1, 2013, the actuarial accrued liability (AAL) for benefits was \$22.7 million and the actuarial value of assets was \$13.4 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$9.3 million. The covered payroll (annual payroll of active employees covered by the plan) was \$725.2 million and the ratio of the UAAL to the covered payroll was 1.3% at June 30, 2013.

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

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

In the July 1, 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, 2012 was 25 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 2012 to 2013. 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. 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 3.5%. The malpractice liability as of June 30, 2013 is based on the requirements of GASB 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, 2013.

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, 2013.

## 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 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's 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, 2013, 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	16
2008 Biennium: Capital Projects	21,927	21,927	21,927	1,715
2008 Biennium: RCTF	<u>28,073</u>	<u>11,406</u>	<u>11,406</u>	<u>644</u>
Total	<u>\$ 350,000</u>	<u>\$ 235,524</u>	<u>\$ 235,524</u>	<u>\$ 2,375</u>

Interest income of approximately \$2.2 million earned on the state matching funds is included in the University's share of the 2000 biennium funding.

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 2013 or prior	\$ 16	\$ 8	\$ 112
Pledges due in fiscal year 2014	-	1,707	383
Pledges due in fiscal year 2015	-	-	149
Total	<u>\$ 16</u>	<u>\$ 1,715</u>	<u>\$ 644</u>

## 22. CANCER RESEARCH MATCHING FUND

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

A summary of the receipts and expenses related to the fund as of June 30, 2013 and 2012 follows (in thousands):

	2013	2012
Funds from private sources approved for match	\$ 6,999	\$ 3,789
Cigarette excise tax funds distributed	2,007	2,275
Total cancer research matching fund revenues	<u>\$ 9,006</u>	<u>\$ 6,064</u>
Cancer research matching fund expenses	<u>\$ 6,987</u>	<u>\$ 7,111</u>

## 23. STUDENT HOUSING PARTNERSHIP

The University entered an agreement in April 2012 with a third party developer, Education Realty Trust (EdR), to construct two four-story buildings, which comprise a 601-bed living-learning community with three classrooms, 16 active-learning spaces, Honor's Program offices, and nine multipurpose meeting spaces on the former site of Haggin Field. The project, with an estimated cost of \$25.2 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 greater of current net book value or \$10. Ground rent will be a percentage of gross revenues. The University will account for the ground lease as an operating lease. These facilities are subject to ad valorem tax. These two residence halls opened on August 16, 2013 for the Fall 2013 semester.

Phases II-A and II-B of the long-term housing plan agreements have also been signed with EdR. These phases include eight residence halls to be constructed between October 2012 and August 2015. The University has received authorization from the Kentucky legislature for the new projects, which the Commonwealth must approve statutorily even though EdR, not the University, is financing the projects.

Phase II-A, expected on line in August 2014, includes the development of five residence halls at an approximate cost of \$138.0 million and Phase II-B, expected on line in August 2015, includes the construction of three residence halls at an approximate cost of \$101.2 million. The 75-year term lease with EdR includes maintenance standards for the facilities and parameters for the room rental rates for the duration. The University will receive a percentage of the total revenues and a share of the net income, after EdR achieves a minimum internal rate of return. These eight facilities are exempt from ad valorem tax. The University will account for the lease as a service concession arrangement in accordance with GASB No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*.

## 24. NATURAL CLASSIFICATION

The University's operating expenses by natural classification were as follows for the years ended June 30, 2013 and 2012 (in thousands):

	<u>2013</u>	<u>2012</u>
Salaries and wages	\$ 1,114,676	\$ 1,115,457
Employee benefits	345,945	352,820
Supplies and services	539,323	583,982
Depreciation	133,066	122,219
Student scholarships and financial aid	48,361	46,985
Purchased utilities	46,760	47,290
Other, various	<u>103,837</u>	<u>76,273</u>
Total	<u>\$ 2,331,968</u>	<u>\$ 2,345,026</u>

## 25. COMBINED CONDENSED STATEMENTS

The University of Kentucky and its blended component units condensed statements were summarized as follows for the years ended June 30, 2013 and 2012 (in thousands):

UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
COMBINED CONDENSED STATEMENT OF NET POSITION AS OF JUNE 30, 2013  
(in thousands)

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Humanities Foundation	Mining Engineering Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
<b>ASSETS</b>										
<b>Current Assets</b>										
Cash and cash equivalents	\$ 336,010	\$ 46,673	\$ 6,992	\$ 128	\$ 98	\$ 6	\$ 82	\$ 498	\$ 1,488	\$ 391,975
Notes, loans and accounts receivable, net	164,710	36,042	2,397	15	-	-	-	-	26,188	229,352
Investments	-	-	-	-	-	-	-	-	6,944	6,944
Inventories and other assets	33,773	2,338	-	-	-	-	-	13	65	36,189
Total current assets	534,493	85,053	9,389	143	98	6	82	511	34,685	664,460
<b>Noncurrent Assets</b>										
Restricted cash and cash equivalents	59,892	-	-	-	-	-	-	-	-	59,892
Endowment investments	1,039,494	3,809	242	7,934	1,226	1,743	-	-	-	1,054,448
Other long-term investments	118,890	1,486	-	-	-	-	-	-	41,198	161,574
Notes, loans and accounts receivable, net	49,639	-	-	-	-	-	-	-	839	50,478
Other noncurrent assets	16,137	162	-	-	-	-	-	-	-	16,299
Capital assets, net	1,892,781	14,704	-	-	-	-	-	161	36,476	1,944,122
Total noncurrent assets	3,176,833	20,161	242	7,934	1,226	1,743	-	161	78,513	3,286,813
Total assets	3,711,326	105,214	9,631	8,077	1,324	1,749	82	672	113,198	3,951,273
<b>LIABILITIES AND DEFERRED INFLOWS OF RESOURCES</b>										
<b>Current Liabilities</b>										
Accounts payable and accrued liabilities	168,636	17,231	419	-	-	7	-	511	5,857	192,661
Unearned revenue	29,861	34,558	133	-	-	-	-	-	-	64,552
Long-term liabilities - current portion	68,731	312	-	-	-	-	-	-	1,265	70,308
Total current liabilities	267,228	52,101	562	-	-	7	-	511	7,122	327,521
<b>Noncurrent Liabilities</b>										
Long-term liabilities	734,848	1,411	-	-	-	-	-	-	20,964	757,223
Total noncurrent liabilities	734,848	1,411	-	-	-	-	-	-	20,964	757,223
Total liabilities	1,002,076	53,512	562	-	-	7	-	511	28,086	1,084,744
Deferred inflows of Resources	561	-	-	-	-	-	-	-	-	561
Total liabilities and deferred inflows of resources	1,002,637	53,512	562	-	-	7	-	511	28,086	1,085,305
<b>INTERFUND BALANCES</b>										
	(29,698)	2,131	779	-	-	-	-	-	26,788	-
<b>NET POSITION</b>										
<b>Net investment in capital assets</b>	1,265,958	14,467	-	-	-	-	-	161	15,366	1,295,952
<b>Restricted</b>										
Nonexpendable	560,949	822	31	4,607	617	650	-	-	-	567,676
Expendable	305,459	3,660	555	3,470	707	1,092	82	-	-	315,025
Total restricted	866,408	4,482	586	8,077	1,324	1,742	82	-	-	882,701
<b>Unrestricted</b>										
	606,021	30,622	7,714	-	-	-	-	-	42,958	687,315
Total net position	\$ 2,738,387	\$ 49,571	\$ 8,300	\$ 8,077	\$ 1,324	\$ 1,742	\$ 82	\$ 161	\$ 58,324	\$ 2,865,968

UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
COMBINED CONDENSED STATEMENT OF NET POSITION AS OF JUNE 30, 2012  
(in thousands)

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Humanities Foundation	Mining Engineering Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
<b>ASSETS</b>										
<b>Current Assets</b>										
Cash and cash equivalents	\$ 244,718	\$ 39,008	\$ 8,201	\$ 8	\$ 63	\$ 16	\$ 11	\$ 555	\$ 1,483	\$ 294,063
Notes, loans and accounts receivable, net	181,800	43,344	2,158	14	-	-	-	-	26,785	254,101
Investments	-	351	-	-	-	-	-	-	8,057	8,408
Inventories and other assets	32,815	2,462	-	-	-	-	-	12	56	35,345
Total current assets	459,333	85,165	10,359	22	63	16	11	567	36,381	591,917
<b>Noncurrent Assets</b>										
Restricted cash and cash equivalents	54,067	-	-	-	-	50	-	-	-	54,117
Endowment investments	933,356	3,598	190	7,505	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	1,922,290	15,092	-	-	-	-	-	224	37,347	1,974,953
Total noncurrent assets	3,064,937	22,412	190	7,519	1,160	1,624	-	224	81,772	3,179,838
Total assets	3,524,270	107,577	10,549	7,541	1,223	1,640	11	791	118,153	3,771,755
<b>LIABILITIES AND DEFERRED INFLOWS OF RESOURCES</b>										
<b>Current Liabilities</b>										
Accounts payable and accrued liabilities	163,105	20,110	438	-	-	1	-	567	6,881	191,102
Unearned revenue	28,986	33,799	67	-	-	-	-	-	-	62,852
Long-term liabilities - current portion	72,742	1,096	-	-	-	-	-	-	2,105	75,943
Total current liabilities	264,833	55,005	505	-	-	1	-	567	8,986	329,897
<b>Noncurrent Liabilities</b>										
Long-term liabilities	742,608	1,778	-	-	-	-	-	-	21,085	765,471
Total noncurrent liabilities	742,608	1,778	-	-	-	-	-	-	21,085	765,471
Total liabilities	1,007,441	56,783	505	-	-	1	-	567	30,071	1,095,368
<b>Deferred Inflows of Resources</b>										
Total liabilities and deferred inflows of resources	1,007,441	56,783	505	-	-	1	-	567	30,071	1,095,368
<b>INTERFUND BALANCES</b>										
	(29,454)	3,520	839	-	-	-	-	-	25,095	-
<b>NET POSITION</b>										
Invested in capital assets, net of related debt	1,269,384	13,907	-	-	-	-	-	224	15,734	1,299,249
<b>Restricted</b>										
Nonexpendable	551,053	755	31	4,607	616	650	-	-	-	557,712
Expendable	233,214	3,510	892	2,934	607	989	11	-	-	242,157
Total restricted	784,267	4,265	923	7,541	1,223	1,639	11	-	-	799,869
<b>Unrestricted</b>										
	492,632	29,102	8,282	-	-	-	-	-	47,253	577,269
Total net position	\$ 2,546,283	\$ 47,274	\$ 9,205	\$ 7,541	\$ 1,223	\$ 1,639	\$ 11	\$ 224	\$ 62,987	\$ 2,676,387

UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
COMBINED CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2013  
(in thousands)

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Humanities Foundation	Mining Engineering Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
<b>OPERATING REVENUES</b>										
Student tuition and fees	\$ 265,293	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 265,293
Federal grants and contracts	1,426	163,788	-	-	-	-	-	-	-	165,214
State and local grants and contracts	39,633	46,528	982	-	-	-	-	-	-	87,143
Nongovernmental grants and contracts	(6,048)	30,321	6,748	-	-	-	-	-	-	31,021
Recoveries of facilities and administrative costs	263	47,599	-	-	-	-	-	-	-	47,862
Sales and services	25,718	10,881	13,833	1	-	31	6,558	-	-	57,022
Federal appropriations	16,890	-	-	-	-	-	-	-	-	16,890
County appropriations	19,312	-	-	-	-	-	-	-	-	19,312
Professional clinical service fees	1	-	-	-	-	-	-	222,474	-	222,475
Hospital services	945,885	-	-	-	-	-	-	-	-	945,885
Auxiliary enterprises:										
Housing and dining	50,426	-	-	-	-	-	-	-	-	50,426
Athletics	72,033	-	-	-	-	-	-	-	-	72,033
Other auxiliaries	30,547	-	-	-	-	-	-	-	-	30,547
Other operating revenues	989	-	-	-	-	-	-	2,783	-	3,772
Total operating revenues	1,462,368	299,117	21,563	1	-	31	6,558	225,257	-	2,014,895
<b>OPERATING EXPENSES</b>										
Educational and general:										
Instruction	244,330	12,998	315	-	-	80	-	-	-	257,723
Research	81,784	165,670	228	9	-	-	-	-	-	247,691
Public service	130,622	98,175	1,149	-	-	-	-	-	-	229,946
Libraries	19,493	-	3	-	-	-	-	-	-	19,496
Academic support	78,498	2,879	4,161	-	-	-	-	-	-	85,538
Student services	32,965	39	1,120	-	1	-	-	-	-	34,125
Institutional support	50,394	818	224	10	-	109	6,549	-	-	58,104
Operations and maintenance of plant	63,202	-	-	-	-	-	-	-	-	63,202
Student financial aid	25,936	1,756	2,529	-	30	-	-	-	-	30,251
Depreciation	67,882	1,553	-	-	-	-	73	-	-	69,508
Total educational and general	795,106	283,888	9,729	19	31	80	6,622	191,659	-	1,095,584
Clinical operations (including depreciation of \$1,995)	-	-	-	-	-	-	-	-	191,659	191,659
Hospital (including depreciation of \$51,261)	891,270	-	55	-	-	-	-	-	-	891,325
Auxiliary enterprises:										
Housing and dining (including depreciation of \$5,020)	47,543	-	-	-	-	-	-	-	-	47,543
Athletics (including depreciation of \$5,282)	84,072	-	-	-	-	-	-	-	-	84,072
Other auxiliaries	21,103	-	-	-	-	-	-	-	-	21,103
Other operating expenses	682	-	-	-	-	-	-	-	-	682
Total operating expenses	1,839,776	283,888	9,784	19	31	80	6,622	191,659	-	2,331,968
Net income (loss) from operations	(377,408)	15,229	11,779	(18)	(31)	(80)	(78)	(64)	33,598	(317,073)
<b>NONOPERATING REVENUES (EXPENSES)</b>										
State appropriations	283,869	-	-	-	-	-	-	-	-	283,869
Gifts and non-exchange grants	97,947	116	107	96	3	-	149	-	-	98,418
Investment income (loss)	103,025	395	37	852	132	187	-	1	119	104,748
Interest on capital asset-related debt	(28,415)	91	-	-	-	-	-	-	(920)	(29,244)
Grant to/(from) the University for non-capital purposes	59,977	(11,186)	(11,233)	(380)	(3)	(4)	-	-	(37,171)	-
Other nonoperating revenues and expenses, net	7,440	2,416	-	-	-	-	-	-	-	9,856
Net nonoperating revenues (expenses)	523,843	(8,168)	(11,089)	568	132	183	149	1	(37,972)	467,647
Net income (loss) before other revenues, expenses, gains, or losses	146,435	7,061	690	550	101	103	71	(63)	(4,374)	150,574
Capital grants and gifts	25,414	5,369	-	-	-	-	-	-	(111)	30,672
Additions to permanent endowments	10,223	2	-	-	-	-	-	-	-	10,225
Grant to/(from) the University for capital purposes	11,487	(9,878)	(1,595)	(14)	-	-	-	-	-	-
Other, net	(1,455)	(257)	-	-	-	-	-	-	(178)	(1,890)
Total other revenues (expenses)	45,669	(4,764)	(1,595)	(14)	-	-	-	-	(289)	39,007
<b>INCREASE (DECREASE) IN NET POSITION</b>	192,104	2,297	(905)	536	101	103	71	(63)	(4,663)	189,581
<b>NET POSITION, beginning of year</b>	2,546,283	47,274	9,205	7,541	1,223	1,639	11	224	62,987	2,676,387
<b>NET POSITION, end of year</b>	\$ 2,738,387	\$ 49,571	\$ 8,300	\$ 8,077	\$ 1,324	\$ 1,742	\$ 82	\$ 161	\$ 58,324	\$ 2,865,968



**UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
COMBINED CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2012  
(in thousands)**

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Humanities Foundation	Mining Engineering Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
<b>OPERATING REVENUES</b>										
Student tuition and fees, net	\$ 243,364	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 243,364
Federal grants and contracts	1,585	178,613	-	-	-	-	-	-	-	180,198
State and local grants and contracts	33,960	73,843	691	-	-	-	-	-	-	108,494
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	-	-	-	-	-	-	-	220,633	-	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	1,391,232	342,274	19,260	-	-	20	6,967	222,288	-	1,982,041
<b>OPERATING EXPENSES</b>										
Educational and general:										
Instruction	255,402	12,729	825	-	6	75	-	-	-	269,037
Research	85,462	177,164	227	5	-	-	-	-	-	262,858
Public service	136,471	129,005	1,082	-	-	-	-	-	-	266,558
Libraries	20,043	-	4	-	-	-	-	-	-	20,047
Academic support	78,826	2,678	4,323	-	-	-	-	-	-	85,827
Student services	32,781	31	287	-	1	-	-	-	-	33,100
Institutional support	53,346	996	360	-	-	149	6,933	-	-	61,784
Operations and maintenance of plant	66,915	453	-	-	-	-	-	-	-	67,368
Student financial aid	25,811	1,719	1,880	-	41	-	-	-	-	29,451
Depreciation	65,889	1,427	-	-	-	-	86	-	-	67,402
Total educational and general	820,946	326,202	8,988	5	48	75	149	7,019	-	1,163,432
Clinical operations (including depreciation of \$1,817)	-	-	-	-	-	-	-	170,727	-	170,727
Hospital (including depreciation of \$45,643)	869,016	-	48	-	-	-	-	-	-	869,064
Auxiliary enterprises:										
Housing and dining (including depreciation of \$3,162)	46,497	-	-	-	-	-	-	-	-	46,497
Athletics (including depreciation of \$4,195)	75,271	-	-	-	-	-	-	-	-	75,271
Other auxiliaries	18,933	-	-	-	-	-	-	-	-	18,933
Other expenses	1,102	-	-	-	-	-	-	-	-	1,102
Total operating expenses	1,831,765	326,202	9,036	5	48	75	149	7,019	170,727	2,345,026
Net income (loss) from operations	(440,533)	16,072	10,224	(5)	(48)	(75)	(129)	(52)	51,561	(362,985)
<b>NONOPERATING REVENUES (EXPENSES)</b>										
State appropriations	297,580	-	-	-	-	-	-	-	-	297,580
Gifts and non-exchange grants	86,265	131	151	95	1	6	86	-	-	86,735
Investment income (loss)	(465)	203	8	(58)	(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	72,436	(8,570)	(11,699)	(364)	(4)	(4)	-	-	(51,795)	-
Other nonoperating revenues and expenses, net	6,369	1,285	-	-	-	-	-	-	-	7,654
Net nonoperating revenues (expenses)	431,275	(7,028)	(11,540)	(327)	(12)	(10)	86	1	(52,859)	359,586
Net income (loss) before other revenues, expenses, gains, or losses	(9,258)	9,044	(1,316)	(332)	(60)	(85)	(43)	(51)	(1,298)	(3,399)
Capital grants and gifts	16,639	23,471	-	-	-	-	-	-	(88)	40,022
Additions to permanent endowments	11,579	2	-	-	-	-	-	-	-	11,581
Grant to/(from) the University for capital purposes	29,876	(28,367)	(1,357)	(152)	-	-	-	-	-	-
Other, net	(3,440)	(482)	-	-	-	-	-	-	-	(3,978)
Total other revenues (expenses)	54,654	(5,376)	(1,357)	(152)	-	-	-	-	(56)	47,625
<b>INCREASE (DECREASE) IN NET POSITION</b>	45,396	3,668	(2,673)	(484)	(60)	(85)	(43)	(51)	(1,442)	44,226
<b>NET POSITION, beginning of year</b>	2,500,887	43,606	11,878	8,025	1,283	1,724	54	275	64,429	2,632,161
<b>NET POSITION, end of year</b>	\$ 2,546,283	\$ 47,274	\$ 9,205	\$ 7,541	\$ 1,223	\$ 1,639	\$ 11	\$ 224	\$ 62,987	\$ 2,676,387

**UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
COMBINED CONDENSED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2013  
(in thousands)**

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Humanities Foundation	Mining Engineering Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>										
Student tuition and fees	\$ 265,136	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 265,136
Grants and contracts	171,488	248,583	7,571	-	-	-	-	-	(146,428)	281,214
Recoveries of facilities and administrative costs	167	49,181	-	-	-	-	-	-	-	49,348
Sales and services	37,648	-	13,732	1	-	-	31	6,172	-	57,584
Federal appropriations	14,858	-	-	-	-	-	-	-	-	14,858
County appropriations	18,935	-	-	-	-	-	-	-	-	18,935
Payments to vendors and contractors	(500,033)	(124,557)	(4,710)	(11)	(31)	(33)	(108)	(1,005)	(69,132)	(699,620)
Student financial aid	(27,641)	-	(2,528)	-	-	-	-	-	-	(30,169)
Salaries, wages and benefits	(1,282,891)	(161,214)	(2,575)	(8)	-	(41)	(1)	(5,215)	(11,044)	(1,462,989)
Professional clinic service fees	-	-	-	-	-	-	-	-	224,818	224,818
Hospital services	973,830	-	-	-	-	-	-	-	-	973,830
Auxiliary enterprise receipts	153,741	-	-	-	-	-	-	-	-	153,741
Loans issued to students	(17,137)	-	-	-	-	-	-	-	-	(17,137)
Collection of loans to students	16,422	-	-	-	-	-	-	-	-	16,422
Self insurance receipts	45,035	-	-	-	-	-	-	-	-	45,035
Self insurance payments	(43,921)	-	-	-	-	-	-	-	-	(43,921)
Other operating receipts (payments), net	(11,857)	10,267	84	-	-	-	-	-	2,324	818
Net cash provided (used) by operating activities	(186,220)	22,260	11,574	(18)	(31)	(74)	(76)	(48)	538	(152,097)
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>										
State appropriations	283,869	-	-	-	-	-	-	-	-	283,869
Gifts and grants received for other than capital purposes:										
Gifts received for endowment purposes	10,303	2	-	-	-	-	-	-	(80)	10,225
Gifts received for other purposes	81,048	116	107	109	3	-	149	-	(1,016)	80,516
Agency and loan program receipts	210,958	-	-	-	-	-	-	-	-	210,958
Agency and loan program payments	(210,594)	-	-	-	-	-	-	-	-	(210,594)
Grants (to) from the University for non-capital purposes	24,255	(12,575)	(11,293)	(380)	(3)	(4)	-	-	-	-
Other noncapital financing receipts (payments), net	22,762	4,697	-	-	-	-	-	-	-	27,459
Net cash provided (used) by noncapital financing activities	422,601	(7,760)	(11,186)	(271)	-	(4)	149	-	(1,096)	402,433
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>										
Capital grants and gifts	30,991	5,369	-	-	-	-	-	-	(111)	36,249
Purchases of capital assets	(99,361)	(2,112)	-	-	-	-	-	(10)	(1,037)	(102,520)
Proceeds from capital debt	30,609	119	-	-	-	-	-	104	-	30,832
Payments to refunding bond agents	(5,633)	-	-	-	-	-	-	-	-	(5,633)
Principal paid on capital debt and leases	(54,472)	(1,246)	-	-	-	-	-	-	(701)	(56,419)
Interest paid on capital debt and leases	(28,706)	91	-	-	-	-	-	-	(920)	(29,535)
Grants (to) from the University for capital purposes	11,560	(9,964)	(1,582)	(14)	-	-	-	-	-	-
Other capital and related financing receipts (payments), net	(258)	387	-	-	-	-	-	-	(170)	(41)
Net cash provided (used) by capital and related financing activities	(115,270)	(7,356)	(1,582)	(14)	-	-	-	(10)	(2,835)	(127,067)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>										
Proceeds from sales and maturities of investments	725,914	3,145	120	5,209	805	1,070	-	-	4,896	741,159
Interest and dividends on investments	16,407	64	15	133	21	29	1	1	(1,194)	15,476
Purchase of investments	(766,315)	(2,688)	(150)	(4,919)	(760)	(1,081)	-	-	(304)	(776,217)
Net cash provided (used) by investing activities	(23,994)	521	(15)	423	66	18	-	1	3,398	(19,582)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	97,117	7,665	(1,209)	120	35	(60)	71	(57)	5	103,687
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	298,785	39,008	8,201	8	63	66	11	555	1,483	348,180
<b>CASH AND CASH EQUIVALENTS, end of year</b>	\$ 395,902	\$ 46,673	\$ 6,992	\$ 128	\$ 98	\$ 6	\$ 82	\$ 498	\$ 1,488	\$ 451,867

**UNIVERSITY OF KENTUCKY  
A COMPONENT UNIT OF THE COMMONWEALTH OF KENTUCKY  
COMBINED CONDENSED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2012  
(in thousands)**

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Humanities Foundation	Mining Engineering Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>										
Student tuition and fees	\$ 243,406	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 243,406
Grants and contracts	169,681	277,044	6,142	-	-	-	-	-	(141,423)	311,444
Recoveries of facilities and administrative costs	324	50,780	-	-	-	-	-	-	-	51,104
Sales and services	26,289	8,706	13,269	-	-	20	6,666	-	-	54,950
Federal appropriations	18,164	-	-	-	-	-	-	-	-	18,164
County appropriations	18,622	-	-	-	-	-	-	-	-	18,622
Payments to vendors and contractors	(494,029)	(153,048)	(6,632)	(3)	(44)	(29)	(149)	(1,137)	(64,305)	(719,376)
Student financial aid	(27,654)	-	(1,880)	-	-	-	-	-	-	(29,534)
Salaries, wages and benefits	(1,264,835)	(167,823)	(628)	(2)	(4)	(46)	-	(5,448)	(10,024)	(1,448,810)
Professional clinic service fees	-	-	-	-	-	-	-	-	222,721	222,721
Hospital services	865,793	-	-	-	-	-	-	-	-	865,793
Auxiliary enterprise receipts	146,504	-	-	-	-	-	-	-	-	146,504
Loans issued to students	(18,914)	-	-	-	-	-	-	-	-	(18,914)
Collection of loans to students	17,397	-	-	-	-	-	-	-	-	17,397
Self insurance receipts	41,852	-	-	-	-	-	-	-	-	41,852
Self insurance payments	(45,597)	-	-	-	-	-	-	-	-	(45,597)
Other operating receipts (payments), net	(2,106)	-	-	-	-	-	-	-	1,217	(889)
Net cash provided (used) by operating activities	(305,103)	15,659	10,271	(5)	(48)	(75)	(129)	81	8,186	(271,163)
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>										
State appropriations	297,580	-	-	-	-	-	-	-	-	297,580
Gifts and grants received for other than capital purposes:										
Gifts received for endowment purposes	11,679	2	-	-	-	-	-	-	(100)	11,581
Gifts received for other purposes	91,406	131	152	109	1	6	86	-	(1,418)	90,473
Agency and loan program receipts	198,305	-	-	-	-	-	-	-	-	198,305
Agency and loan program payments	(197,994)	-	-	-	-	-	-	-	-	(197,994)
Grants (to) from the University for non-capital purposes	20,842	(8,838)	(11,632)	(364)	(4)	(4)	-	-	-	-
Other noncapital financing receipts (payments), net	14,452	1,857	-	-	(4)	-	-	-	-	16,309
Net cash provided (used) by noncapital financing activities	436,270	(6,848)	(11,480)	(255)	(3)	2	86	-	(1,518)	416,254
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>										
Capital grants and gifts	11,668	23,471	-	-	-	-	-	-	(88)	35,051
Purchases of capital assets	(196,217)	(3,227)	-	-	-	-	-	(34)	(1,727)	(201,205)
Proceeds from capital debt	38,020	591	-	-	-	-	-	-	-	38,611
Payments to refunding bond agents	(33,115)	-	-	-	-	-	-	-	-	(33,115)
Principal paid on capital debt and leases	(65,433)	(1,308)	-	-	-	-	-	-	(735)	(67,476)
Interest paid on capital debt and leases	(32,029)	(77)	-	-	-	-	-	-	(1,164)	(33,270)
Grants (to) from the University for capital purposes	29,180	(27,671)	(1,357)	(152)	-	-	-	-	-	-
Other capital and related financing receipts (payments), net	(2,951)	242	-	-	-	-	-	-	412	(2,297)
Net cash provided (used) by capital and related financing activities	(240,877)	(7,979)	(1,357)	(152)	-	-	-	(34)	(3,302)	(253,701)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>										
Proceeds from sales and maturities of investments	562,600	2,096	94	3,479	570	721	-	-	1,445	571,005
Interest and dividends on investments	21,474	577	13	124	19	27	124	1	461	22,696
Purchase of investments	(503,233)	(2,161)	(81)	(3,183)	(492)	(667)	-	-	(6,880)	(516,697)
Net cash provided (used) by investing activities	80,841	512	26	420	97	81	-	1	(4,974)	77,004
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(28,869)	1,344	(2,540)	8	46	8	(43)	48	(1,608)	(31,606)
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	327,654	37,664	10,741	-	17	58	54	507	3,091	379,786
<b>CASH AND CASH EQUIVALENTS, end of year</b>	\$ 298,785	\$ 39,008	\$ 8,201	\$ 8	\$ 63	\$ 66	\$ 11	\$ 555	\$ 1,483	\$ 348,180

**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, 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%
July 1, 2013	\$ 75,362	\$ 252,938	\$ 177,576	29.8%	\$ 526,073	33.7%

Schedule of Employer Contributions  
(In thousands)

Year Ended	Annual Required Contributions	Percentage Contributed
June 30, 2011	\$ 24,004	103.6%
June 30, 2012	\$ 19,798	98.2%
June 30, 2013	\$ 20,392	100.4%

**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, 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%
July 1, 2013	\$ 13,362	\$ 22,667	\$ 9,305	58.9%	\$ 725,189	1.3%

Schedule of Employer Contributions  
(In thousands)

Year Ended	Annual Required Contributions	Percentage Contributed
June 30, 2011	\$ 2,844	99.7%
June 30, 2012	\$ 1,953	120.9%
June 30, 2013	\$ 2,012	99.8%

**University of Kentucky**  
**Governing Board as of June 30, 2013**

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