

Humanities Foundation, Inc.

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# 2019 Financial Statements



**University of Kentucky**  
**Humanities Foundation, Inc.**  
**A Component Unit of the University of Kentucky**  
**Financial Statements**  
**Years Ended June 30, 2019 and 2018**

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## Independent Auditor's Report

Board of Directors  
University of Kentucky  
Humanities Foundation, Inc.  
Lexington, Kentucky

We have audited the accompanying financial statements of the University of Kentucky Humanities Foundation, Inc. (Foundation), a not-for-profit corporation affiliated with and a component unit of the University of Kentucky (University), as of and for the years ended June 30, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the Foundation's basic 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 conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 entity'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 entity'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 that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 2019 and 2018, and the changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a 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 audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Foundation's basic financial statements. The board of directors listing, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The board of directors listing has not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

*BKD, LLP*

Louisville, Kentucky  
October 8, 2019

**UNIVERSITY OF KENTUCKY  
HUMANITIES FOUNDATION, INC.  
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEARS ENDED JUNE 30, 2019 AND 2018**

The University of Kentucky Humanities Foundation's (the Foundation) Management's Discussion and Analysis (MD&A) of its financial condition provides an overview of the financial performance of the Foundation for the years ended June 30, 2019 and 2018. Management has prepared this discussion, which provides summary financial information, along with the financial statements and related footnotes. MD&A should be read in conjunction with the accompanying financial statements.

**Financial Highlights**

- Total assets increased \$29,992 or 2.0%, primarily due to an increase in the market value of endowment investments of \$50,518, offset by a decrease of \$20,026 in cash and cash equivalents.
- Net position increased \$29,992 or 2.0%, as a result of operating revenues in excess of operating expenses. Net position represents 100% of total assets.

**Using the Financial Statements**

This financial report consists of three financial statements: the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*.

One of the most important questions asked about the Foundation's finances is whether the Foundation is better off as a result of the year's activities. One key to answering this question is the financial statements of the Foundation. The Statement of Net Position; Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows present financial information on the Foundation in a format similar to that used by corporations and present a long-term view of the Foundation's finances. The Foundation's net position (the difference between assets, deferred outflows of resources, liabilities, and deferred inflows of resources) is one sign of the Foundation's financial health. Over time, increases or decreases in net position indicate the improvement or erosion of the Foundation's financial health.

The Statement of Net Position includes all assets, deferred outflows of resources, liabilities, and deferred inflows of resources. It 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.

The Statement of Revenues, Expenses and Changes in Net Position presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. Gifts and endowment and investment income (loss) are classified as operating revenues (losses) because fundraising activities represent the Foundation's primary operating purpose.

Another important factor to consider when evaluating financial viability is the Foundation's ability to meet financial obligations as they become due. The Statement of Cash Flows presents information related to cash inflows and outflows, summarized by operating, noncapital financing, capital and related financing and investing activities.

## Reporting Entity

The University of Kentucky Humanities Foundation, Inc. is a not-for-profit Kentucky corporation formed for the enhancement and improvement of the humanities programs of the University of Kentucky (the University). The Foundation was established by a gift to the University in the amount of \$500,000 from Mr. and Mrs. John R. Gaines. The Foundation is considered to be an affiliate and component unit of the University because all Foundation Board of Directors members are related to the University as faculty or staff and are appointed by the University Board of Trustees upon the recommendation of the president of the University, and certain officers of the Foundation are officers of the University.

### Condensed Financial Information

#### Statements of Net Position

	2019	2018	2017
<b>ASSETS</b>			
Current assets	\$ —	\$ 20,026	\$ 58,579
Noncurrent assets	1,495,302	1,445,284	1,385,511
Total assets	1,495,302	1,465,310	1,444,090
<b>LIABILITIES</b>			
Current liabilities	—	—	—
Total liabilities	—	—	—
<b>NET POSITION</b>			
Restricted			
Nonexpendable	617,746	617,746	617,746
Expendable	877,556	847,564	826,344
Total net position	\$ 1,495,302	\$ 1,465,310	\$ 1,444,090

**Assets.** As of June 30, 2019, the Foundation's total assets, comprised entirely of endowment investments, amounted to \$1,495,302. Total assets increased by \$29,992 during the year ended June 30, 2019 due to an increase of \$50,518 in the market value of endowment investments, offset by a decrease of \$20,026 in cash and cash equivalents.

**Liabilities:** As of June 30, 2019, the Foundation had no liabilities.

**Net Position.** Net position at June 30, 2019 totaled \$1,495,302, 100% of total assets, all of which were restricted. Total net position increased \$29,992 during the year ended June 30, 2019 due primarily to a decrease in operating expenses compared to prior year.

**2018 Versus 2017.** Total net position increased \$21,220 from June 30, 2017 to June 30, 2018, primarily due to realized and unrealized gains on endowment investments.

**Statements of Revenues, Expenses and Changes in Net Position**

	<u>2019</u>	<u>2018</u>	<u>2017</u>
<b>OPERATING REVENUES</b>			
Operating revenues	\$ 78,921	\$ 82,734	\$ 125,734
Total operating revenues	<u>78,921</u>	<u>82,734</u>	<u>125,734</u>
<b>OPERATING EXPENSES</b>			
Educational and general	37,651	54,587	43,442
Grants to the University of Kentucky	11,278	6,927	6,596
Total operating expenses	<u>48,929</u>	<u>61,514</u>	<u>50,038</u>
<b>NET INCOME FROM OPERATIONS</b>	<u>29,992</u>	<u>21,220</u>	<u>75,696</u>
<b>INCREASE IN NET POSITION</b>	29,992	21,220	75,696
<b>NET POSITION, beginning of year</b>	<u>1,465,310</u>	<u>1,444,090</u>	<u>1,368,394</u>
<b>NET POSITION, end of year</b>	<u>\$ 1,495,302</u>	<u>\$ 1,465,310</u>	<u>\$ 1,444,090</u>

**2019.** Operating revenues, comprised primarily of investment income, decreased \$3,813 from the previous year due to decreased gains on endowment investments. The endowment pool posted a total gain of 4.4% for fiscal year 2019 compared to a total gain of 5.6% for fiscal year 2018.

Operating expenses totaled \$48,929 of which 77.0% was used for educational and general expenses, primarily student financial aid. Operating expenses decreased \$12,585 due to a decrease in instruction, student services, and student financial aid, offset by an increase in grants to the University.

**2018 Versus 2017.** Operating revenues decreased \$43,000 when comparing fiscal year 2018 to 2017, due to decreased gains on endowment investments. Operating expenses increased \$11,476 from fiscal year 2017 to fiscal year 2018 primarily due to an increase in instruction and student financial aid.

Another way to assess the financial health of an organization is to look at the Statement of Cash Flows. The primary purpose of the Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the Foundation during the period. The Statement of Cash Flows also helps financial statement readers assess the Foundation's:

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

**Statements of Cash Flows**

	2019	2018	2017
<b>CASH PROVIDED (USED) BY:</b>			
Operating activities	\$ (48,329)	\$ (61,014)	\$ (47,314)
Investing activities	28,303	22,461	19,242
Net decrease in cash and cash equivalents	(20,026)	(38,553)	(28,072)
<b>Cash and cash equivalents, beginning of year</b>	20,026	58,579	86,651
<b>Cash and cash equivalents, end of year</b>	\$ —	\$ 20,026	\$ 58,579

**2019.** Cash payments for operating activities included \$37,651 to vendors and contractors and \$11,278 to the University for noncapital grants. Net cash provided by investing activities of \$28,303 was primarily due to the interest and dividends on investments received.

**2018 Versus 2017.** Net cash used by operating activities increased \$13,700 when comparing fiscal year 2018 to fiscal year 2017 primarily due to more cash used for payments to vendors and contractors. Net cash provided by investing activities increased \$3,219 primarily due to the proceeds from sales and maturities of investments and interest and dividends net of investment purchases.

**Capital Assets and Debt Administration**

**Capital Assets.** Capital assets purchased by the Foundation are granted to the University of Kentucky at the time of acquisition.

**Debt.** The Foundation had no debt at or during the years ended June 30, 2019 or 2018.

**Factors Impacting Future Periods**

Although the economy continues to show signs of improvement, investment losses could negatively impact the Foundation's future financial results.



UNIVERSITY OF KENTUCKY HUMANITIES FOUNDATION, INC.  
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY  
STATEMENTS OF NET POSITION  
JUNE 30, 2019 AND 2018

	<u>2019</u>	<u>2018</u>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ —	\$ 20,026
Total current assets	<u>—</u>	<u>20,026</u>
<b>Noncurrent Assets</b>		
Endowment investments	1,495,302	1,444,784
Other long-term investments	—	500
Total noncurrent assets	<u>1,495,302</u>	<u>1,445,284</u>
Total assets	<u>1,495,302</u>	<u>1,465,310</u>
<b>LIABILITIES</b>		
<b>Current Liabilities</b>		
Total current liabilities	<u>—</u>	<u>—</u>
Total liabilities	<u>—</u>	<u>—</u>
<b>NET POSITION</b>		
<b>Restricted</b>		
Nonexpendable	617,746	617,746
Expendable	<u>877,556</u>	<u>847,564</u>
Total restricted	<u>1,495,302</u>	<u>1,465,310</u>
Total net position	<u>\$ 1,495,302</u>	<u>\$ 1,465,310</u>

See notes to financial statements

**UNIVERSITY OF KENTUCKY HUMANITIES FOUNDATION, INC.**  
**A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**  
**FOR THE YEARS ENDED JUNE 30, 2019 AND 2018**

	<u>2019</u>	<u>2018</u>
<b>OPERATING REVENUES</b>		
Gifts	\$ 600	\$ 500
Investment income	78,321	82,234
Total operating revenues	<u>78,921</u>	<u>82,734</u>
<b>OPERATING EXPENSES</b>		
Educational and general:		
Instruction	—	6,000
Student services	151	587
Student financial aid	37,500	48,000
Total educational and general	<u>37,651</u>	<u>54,587</u>
Grants to the University of Kentucky for non-capital purposes	11,278	6,927
Total operating expenses	<u>48,929</u>	<u>61,514</u>
Net income from operations	29,992	21,220
<b>INCREASE IN NET POSITION</b>	29,992	21,220
<b>NET POSITION, beginning of year</b>	<u>1,465,310</u>	<u>1,444,090</u>
<b>NET POSITION, end of year</b>	<u>\$ 1,495,302</u>	<u>\$ 1,465,310</u>

See notes to financial statements

**UNIVERSITY OF KENTUCKY HUMANITIES FOUNDATION, INC.  
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2019 AND 2018**

	<u>2019</u>	<u>2018</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Private gifts	\$ 600	\$ 500
Payments to vendors and contractors	(37,651)	(54,587)
Grants to the University of Kentucky for non-capital purposes	<u>(11,278)</u>	<u>(6,927)</u>
Net cash used by operating activities	<u>(48,329)</u>	<u>(61,014)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales and maturities of investments	531,800	915,521
Interest and dividends on investments	24,276	22,962
Purchase of investments	<u>(527,773)</u>	<u>(916,022)</u>
Net cash provided by investing activities	<u>28,303</u>	<u>22,461</u>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	(20,026)	(38,553)
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>20,026</u>	<u>58,579</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ —</u>	<u>\$ 20,026</u>
<b>Reconciliation of net income from operations to net cash used by operating activities:</b>		
Net income from operations	\$ 29,992	\$ 21,220
Adjustments to reconcile net income from operations to net cash used by operating activities:		
Investment income	<u>(78,321)</u>	<u>(82,234)</u>
<b>Net cash used by operating activities</b>	<u>\$ (48,329)</u>	<u>\$ (61,014)</u>

See notes to financial statements

**UNIVERSITY OF KENTUCKY  
HUMANITIES FOUNDATION, INC.  
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2019 AND 2018**

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

**Reporting Entity**

The University of Kentucky Humanities Foundation, Inc. (the Foundation) is a not-for-profit Kentucky corporation formed for the enhancement and improvement of the humanities programs of the University of Kentucky (the University). The Foundation was established during fiscal year 1985 by a gift to the University in the amount of \$500,000 from Mr. and Mrs. John R. Gaines. The Foundation is considered to be an affiliate and component unit of the University because all Foundation Board of Directors members are related to the University as faculty or staff and are appointed by the University Board of Trustees upon the recommendation of the president of the University, and certain officers of the Foundation are officers of the University.

**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 Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and 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 Foundation. Such assets include the Foundation’s permanent endowment funds.
  - Expendable* – Net position whose use by the Foundation is subject to externally imposed stipulations that can be fulfilled by actions of the Foundation pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net position whose use by the Foundation is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors 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 Foundation’s assets, deferred outflows of resources, liabilities, deferred inflows of resources, net position, revenues, expenses, changes in net position and cash flows.

**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.

Cash and Cash Equivalents. The Foundation considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents of the Foundation’s endowment fund are included in noncurrent endowment investments.

Pooled Endowment Funds. All endowments are managed in a consolidated investment pool, which consists of more than 2,300 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 of Kentucky (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 makes 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 with the long-term objective to maintain the purchasing power of each endowment and provide a predictable and sustainable level of income to support current operations.

The adopted spending policy is a “hybrid” policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending is 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 is constrained so that the calculated rate is at least three percent, and not more than six percent, of the current endowment market value.

The University also utilizes an endowment management fee to support internal management and fundraising costs related to the endowment. The University’s annual endowment management fee was 0.82% and 0.50% for the years ended June 30, 2019 and 2018 respectively.

To protect endowment funds from permanent impairment of value, spending and management fee withdrawals are suspended on endowments with a market value less than the contributed value by more than 20%. Additionally, endowments with a market value less than the contributed value by more than 10% undergo a formal review to determine the appropriate level of spending in accordance with various factors set forth in UPMIFA. All donor restrictions and stipulations prevail in decisions regarding preservation and spending of endowment funds.

The amount of gross spending policy distribution in accordance with the University’s endowment spending policy was \$48,255 and \$47,239 for the years ended June 30, 2019 and 2018, respectively.

Investments. Investments in marketable securities are carried at fair value. See footnote 2 for more information on the fair value determination. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income (loss) in the Statement of Revenues, Expenses and Changes in Net Position.

Income Taxes. The Foundation has been granted exemption from federal income taxation pursuant to the provisions of Internal Revenue Code section 501(c)(3).

Restricted Asset Spending Policy. The Foundation’s policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination of 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 Foundation 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. Gifts and endowment and investment income are also classified as operating revenue because fundraising activities support the Foundation’s primary operating purpose.

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 accrued expenses for payroll and other liability accounts.

## 2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2019 and 2018 are as follows:

	2019	2018
Cash and cash equivalents on deposit with the University	\$ —	\$ 20,026
Investment in University pooled endowment fund	1,495,302	1,444,784
Other long-term investments	—	500
Total	\$ 1,495,302	\$ 1,465,310

Fair Value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at a measurement date. The framework for measuring fair value established by generally accepted accounting principles provides a fair value hierarchy as follows:

- Level 1      Quoted prices in active markets for identical assets or liabilities.
- Level 2      Observable inputs other than level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3      Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities.

Cash and cash equivalents on deposit with the University are based on the historical cost and therefore is not classified in the fair value hierarchy. The investment in University pooled endowment fund is derived based on the per unit calculation as described in footnote 1, thus is deemed to be a level 3 investment. Other long-term investments consist of global equity U.S. stock valued as a level 1 investment. For more information regarding the fair value measurements, refer to the University's financial statements, footnote 2. There have been no significant changes in the valuation techniques during the year ended June 30, 2019.

The composition of the University's pooled endowment fund based upon fair value at June 30, 2019 and 2018 is as follows:

	2019	2018
Cash and cash equivalents	0.2%	0.3%
Diversifying strategies	14.9%	19.0%
Global equity - hedged	6.0%	6.0%
Global equity - international	17.6%	14.6%
Global equity - private	16.1%	15.0%
Global equity - U.S.	12.4%	9.3%
Global fixed income - high quality/rate sensitive	6.9%	7.6%
Global fixed income - private credit	3.1%	2.9%
Global fixed income - public credit	5.8%	6.1%
Real assets - private	10.0%	8.2%
Real assets - public	7.0%	11.0%
Total	100.0%	100.0%

Deposit and Investment Policies. The Foundation follows the deposit and investment policies established by the University of Kentucky's Board of Trustees. Such policies are developed to establish and maintain sound financial management practices for the investment and management of the Foundation's funds.

For purposes of investment management, the Foundation's deposits and investments can be grouped into two significant categories:

- Cash and cash equivalents on deposit with the University, which the University invests in deposits with banks and the Commonwealth. The University also invests cash on deposit in money market funds and the University's pooled endowment fund.
- Endowment investments in the University's pooled endowment fund.

Cash and cash equivalents on deposit with the University are managed based on the University's Operating Fund Investment Policy established by the Treasurer of the University.

Endowment investments are managed within guidelines established by the University's Endowment Investment Policy, as approved by the Investment Committee of the University's Board of Trustees, which governs the University's pooled endowment fund.

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

- Cash and cash equivalents on deposit with the University are governed by policy that minimizes risk in several ways. The University's deposits, in Federal Deposit Insurance Corporation (FDIC) insured financial institutions, are covered up to \$250,000 at each FDIC insured institution, state law requires that deposits in excess of this coverage be fully collateralized. Depository institutions issue a pledge of specific U.S. Treasury or agency securities, held in the name of the University by the Federal Reserve Bank, to cover all amounts over the \$250,000 coverage.
- Deposits with the Commonwealth consist of securities eligible for short-term investments under state law. The University invests a portion of its operating cash in a diversified pool of money market funds. Fund investments include U.S. Treasury and agency securities, certificates of deposit, commercial paper, repurchase agreements and other short-term fixed income securities.

- Endowment managers are permitted to use derivative instruments to limit credit risk.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Foundation 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:

- Cash and cash equivalents on deposit with the University invested in deposits and money market funds are held in the University's name by various financial institutions. Deposits with the Commonwealth are held in the Commonwealth's name. The University maintains records evidencing the Foundation's ownership interest in such balances.
- Endowment investments are held in the University's name by the University's custodian. The University maintains records of the Foundation's ownership interest (units) in the University's pooled endowment fund.

Concentrations of Credit Risk. The Foundation's 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:

- Cash and cash equivalents on deposit with the University are not limited as to the maximum amount that may be invested in one issuer. However, the University's cash deposits in excess of federal deposit 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.
- The University's endowment fixed income managers are limited to a maximum investment in any one issuer of no more than five percent of total investments excluding sovereign debt of governments belonging to the Organization for Economic Cooperation and Development and U.S. agencies.

At June 30, 2019, the Foundation had no underlying investments in any one issuer which represented more than five percent of total investments, other than U.S. Treasury and agency obligations.

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:

- Cash and cash equivalents on deposit with the University have limited exposure to interest rate risk due to the short-term nature of the investment. The University requires that all deposits and money market funds be available for use on the next business day.
- Endowment managers are permitted to use derivative instruments to limit interest rate risk. Additionally, endowment investments held by the University's core-plus fixed income manager are limited to a duration that is within two years of the duration of the Barclays U.S. Aggregate Bond Index and unconstrained fixed income strategies have been implemented to further mitigate interest rate risk.

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 Foundation's exposure to foreign currency risk derives from certain endowment investments in the University's pooled endowment fund. The University's 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.



### 3. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Interest and dividends earned on endowment investments	\$ 22,237	\$ 21,951
Realized and unrealized gains on endowment investments	54,045	59,272
Interest on cash and non-endowment investments	<u>2,039</u>	<u>1,011</u>
Total	<u>\$ 78,321</u>	<u>\$ 82,234</u>

### 4. RISK MANAGEMENT

The Foundation is exposed to various risks of loss related to torts and errors and omissions. These risks are covered by extension of coverage by the University's participation in an insurance risk retention group and self-insurance. Claims against directors and officers for wrongful acts (errors and omissions) are insured through a risk retention group. There have been no significant reductions in insurance coverage from 2018 to 2019. Settlements have not exceeded insurance coverage during the past three years.

### 5. TRANSACTIONS WITH THE UNIVERSITY OF KENTUCKY

Grants to the University of Kentucky are for endowment management fees.

## BOARD OF DIRECTORS

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## OFFICERS

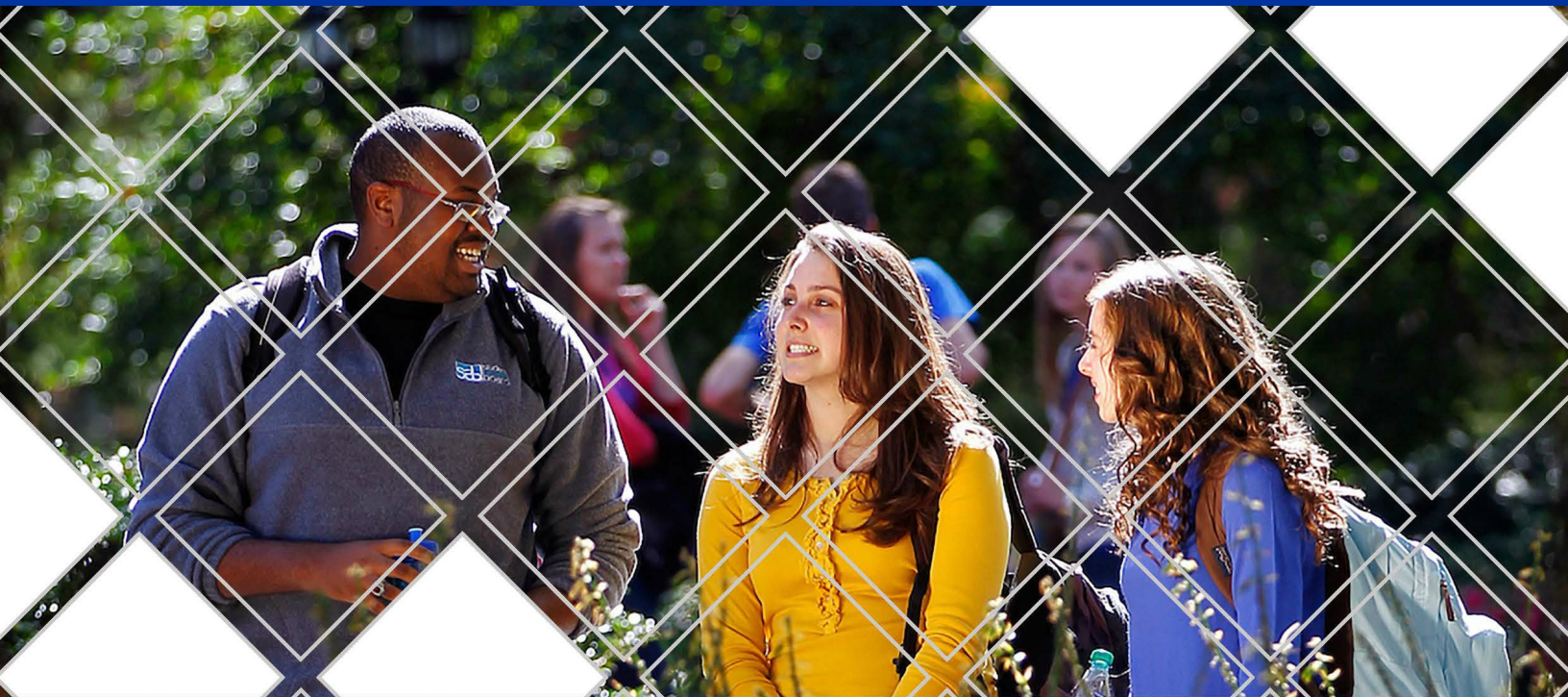
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Josephine D. Richardson, Secretary

## HONORARY MEMBERS

Edmund Pellegrino

University Financial Services  
301 Peterson Service Building  
Lexington, KY 40506-0005

[www.uky.edu/ufs/financial-statements-and-investor-information](http://www.uky.edu/ufs/financial-statements-and-investor-information)



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