



UK HealthCare Hospital System

UNIVERSITY OF KENTUCKY • 2022 FINANCIAL STATEMENTS

UK HealthCare Hospital System
An Organizational Unit of the University of Kentucky
Financial Statements
Year Ended June 30, 2022

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Independent Auditor's Report

Board of Trustees
UK HealthCare Hospital System
University of Kentucky
Lexington, Kentucky

Opinion

We have audited the accompanying financial statements of the UK HealthCare Hospital System (System), an organizational unit of the University of Kentucky (University), as of and for the year ended June 30, 2022, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2022 and the changes in financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the "Auditor's Responsibilities for the Audit of the Financial Statements" section of our report. We are required to be independent of the System and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matters

As discussed in Note 1, the financial statements of the System are intended to present the financial position, changes in financial position, and cash flows of only that portion of the business-type activities that is attributable to the transactions of the System. They do not purport to, and do not, present fairly the financial position of the University as of June 30, 2022, the changes in its financial position or its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 1 to the financial statements, in 2022, the System adopted Governmental Accounting Standards Board (GASB) Statement No. 87, *Leases*. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the System's ability to continue as a going concern for 12 months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 System's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the System's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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 GAAS, 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.

FORVIS, LLP

Louisville, Kentucky
October 7, 2022

**UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2022**

The following Management's Discussion and Analysis (MD&A) provides an overview of the financial position and activities of the UK HealthCare Hospital System for the year ended June 30, 2022. UK HealthCare Hospital System includes Albert B. Chandler University Hospital, including Kentucky Children's Hospital (collectively Chandler); UK HealthCare Good Samaritan Hospital (Good Samaritan); Kentucky HealthCare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary; Surgery Blue LLC, a wholly owned for-profit subsidiary, its for-profit subsidiary, Surgery Center of Lexington, LLC (51% ownership); and Beyond Blue Corporation, a wholly owned non-profit subsidiary (collectively, the System or UK HealthCare). Management has prepared this discussion and we encourage you to read it in conjunction with the financial statements and the notes appearing in this report.

About UK HealthCare Hospital System

UK HealthCare, the University of Kentucky's (the University) advanced academic medical center and clinical care network, is uniquely equipped to provide advanced subspecialty care to the people of Kentucky. The academic medical center and health system provides patient care on par – in terms of both volume and complexity – with the nation's top 25% of academic medical centers. In July 2022, UK HealthCare was listed number one in Kentucky in the latest U.S. News and World Report's Best Hospital's ranking for the seventh year in a row. To be recognized as a Best Hospital, UK HealthCare had to rank high nationally on a stringent data-driven ratings system that gauges performance. The analysis includes multiple clinical specialties, procedures and conditions. Scores are based on a variety of patient outcome and care-related factors such as mortality and patient safety, as well as reputation.

The System operates two hospital units under one Joint Commission Accreditation and two licenses in addition to ambulatory services. The major service units include Albert B. Chandler Hospital, Good Samaritan Hospital and the Kentucky Clinic. The System has a combined total of 965 licensed beds with an average daily census of 832 patients. On a monthly basis, the system provides over 1,210 inpatient surgeries, 1,657 outpatient surgeries, 38,849 radiology procedures, 9,210 emergency department visits, and 97,436 ambulatory clinic visits. In fiscal year 2022, UK HealthCare was given a three star rating by the Centers for Medicare and Medicaid Services.

Under a management contract entered into with the Kentucky Cabinet for Health and Family Services, the System also operates and manages Eastern State Hospital, a 300,000 square-foot facility located on the University's Coldstream Research Campus. The psychiatric facility, opened in September 2013, provides a modern setting for both acute and long-term inpatient psychiatric treatment for adults living within Fayette County and the 50 surrounding counties.

UK HealthCare's Markey Cancer Center remains the state's only cancer center designated by the National Cancer Institute (NCI), which reflects the University's position as a frontrunner in cancer treatment and research. UK HealthCare is one of an elite group of medical centers in the United States that have an NCI designation, a federally funded Center on Aging, and a highly prized Clinical and Translational Science Award grant.

UK HealthCare's dramatic growth within the last decade is in large part the result of a commitment to support the state's overall system of care by working hand-in-hand with local community providers to bring specialty care closer to the patient. These relationships take on different dimensions in each locality (management agreements, affiliate networks, outreach, etc.) and support keeping less acute care in the local community and smoothing the process for more complex, serious cases to be treated in UK HealthCare's Lexington facilities. The goal is better care at all points of the continuum.

Financial Highlights

The System's overall financial position remains strong with assets of \$3.42 billion, deferred outflows of resources of \$3.4 million, liabilities of \$823.8 million, and deferred inflows of resources of \$68 thousand. Net position, which represents the System's residual interest in assets after liabilities are deducted, was \$2.60 billion or 76.0% of total assets. For the fiscal year ended June 30, 2022, the System reported net income before other revenues, expenses, gains and losses of \$447.7 million, generating a margin of 15.8%.

Financial results for fiscal year 2022 exceeded prior year's revenues with net outpatient revenues, including the provision for doubtful accounts, increasing approximately \$170.2 million or 16.2% over the prior fiscal year and net inpatient revenues, including the provision for doubtful accounts, which increased \$162.7 million or 13.6% over the previous fiscal year. The primary driver was that the System was able to recognize \$554.9 million of Medicaid Directed Payments revenue during the current fiscal year.

- Total assets increased \$391.2 million or 12.9%. This is due to increases in accounts receivable, net, of \$164.6 million, cash and cash equivalents of \$126.8 million, estimated third-party payer settlements of \$75.6 million, and leases, net of \$67.6 million. This increase was offset by decreases in long-term investments of \$30.4 million, capital assets, net, of \$10.7 million, inventories and other assets of \$918 thousand, other noncurrent assets of \$559 thousand, and notes receivable of \$538 thousand.
- Deferred outflows of resources decreased \$1.0 million, which represents the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt.
- Total liabilities decreased \$7.3 million or 0.9% as a result of decreases in unearned revenue of \$39.0 million, other long-term liabilities of \$6.6 million, and long-term debt of \$3.3 million. These decreases were offset by increases in lease liabilities of \$65.4 million and accounts payable and accrued expenses of \$698 thousand.
- Deferred inflows of resources decreased \$11 thousand, which represents the beneficial interest from an irrevocable external trust that the system will receive in future years.
- Total net position increased \$397.5 million or 18.1% primarily due to the current year net income.
- Operating revenues increased \$322.7 million or 12.9% primarily due to an increase in net patient revenue of \$293.5 million.
- Operating expenses increased \$398.8 million or 20.7%. The largest increases came from personnel costs of \$186.3 million, purchased services of \$108.7 million, and supplies of \$72.0 million.
- The net nonoperating revenues and expenses decrease of \$165.2 million is primarily due to losses on investments going from a gain last year to a loss this year, resulting in a decrease of \$127.8 million, \$30.2 million increase in other nonoperating expenses, \$8.5 million decrease in COVID-19 funding and interest expense increase of \$2.7 million. This decrease is offset by increases of revenue from \$1.9 million in gain on disposal of capital assets, \$1.2 million in capital gifts and \$810 thousand in gifts and non-exchange grants.

Operating Statistics

The following table presents utilization statistics for the System for fiscal years ended 2022 and 2021:

Discharges:	2022	2021
Medicare	14,149	13,502
Medicaid	13,456	13,562
Commercial/Blue Cross	10,079	9,997
Patient/Charity	684	446
Total discharges	38,368	37,507
Average daily census	832.00	787.29
Average length of stay	7.92	7.66
Emergency visits	110,524	94,459

2022. Total discharges increased by 861 or 2.3% compared to the prior fiscal year. The increase occurred due to increases in Medicare discharges of 647, Commercial/Blue Cross of 82, and Patient/Charity of 238. The increase was offset by a decrease in Medicaid discharges of 106. Overall, the Diagnosis-Related Group case mix index increased to 2.2496 from 2.2395 and the average length of stay increased by 0.26 days to 7.92 days. The case mix for Chandler was at 2.4016 while Good Samaritan was at 1.6141. Emergency visits increased by 16,065 or 17.0% over the prior year.

Using the Financial Statements

The System 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*. In addition to this MD&A section, the financial report includes a Statement of Net Position, Statement of Revenues, Expenses and Changes in Net Position, Statement of Cash Flows and Notes to the Financial Statements. GASB requires that statements be presented on a System-wide basis.

The System implemented GASB Statement No. 87, *Leases* in fiscal year 2022. The financial statements for fiscal year 2021 were not restated for this implementation.

Reporting Entity

The System is an organizational unit of the University, which 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 System include Kentucky Healthcare Enterprise, Inc., a wholly owned for-profit subsidiary; Surgery Blue, LLC, a wholly owned for-profit subsidiary, its for-profit subsidiary, Surgery Center of Lexington, LLC (51% ownership); and Beyond Blue Corporation, a wholly owned non-profit subsidiary. The System provides inpatient, outpatient, and emergency care services for residents of the Commonwealth.

Statement of Net Position

The Statement of Net Position is the System’s balance sheet. It reflects the total assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (equity) of the System as of June 30, 2022. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Net position, the difference between total assets plus deferred outflows of resources and total liabilities plus deferred inflows of resources, is an important indicator of the System’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, deferred outflows of resources, 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 System's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position at June 30, 2022 and 2021 are as follows:

Condensed Statements of Net Position (in thousands)

	2022	2021
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
Current assets	\$ 1,765,310	\$ 1,389,160
Capital assets, net	1,129,173	1,140,183
Lease assets, net	67,640	—
Other noncurrent assets	457,412	498,997
Deferred outflows of resources	3,373	4,403
Total assets and deferred outflows of resources	3,422,908	3,032,743
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES		
Current liabilities	273,139	293,851
Noncurrent liabilities	550,668	537,282
Deferred inflows of resources	68	79
Total liabilities and deferred inflows of resources	823,875	831,212
NET POSITION		
Net investment in capital assets	597,024	587,407
Nonexpendable other	1,862	1,667
Restricted expendable	6,044	11,735
Unrestricted	1,994,103	1,600,722
Total net position	\$ 2,599,033	\$ 2,201,531

Assets. As of June 30, 2022, the System's total assets amounted to approximately \$3.42 billion. Capital assets, net of depreciation, of \$1.13 billion or 33.0% of total assets represented the System's largest asset. Cash and cash equivalents of \$1.15 billion or 33.7% of total assets is the second largest asset, and accounts receivable, net, primarily patient-related, of \$428.8 million or 12.5% was the System's third largest asset. Long-term investments of \$380.1 million or 11.1% of total assets represents another significant asset of the System.

Total assets increased by \$391.2 million during the year ended June 30, 2022. The increase was the result of several factors: accounts receivable, net, increased \$164.6 million, cash and cash equivalents increased \$126.8 million, estimated third-party payer settlements increased \$75.6 million, and leases, net increased \$67.6 million. These increases were offset by decreases in long-term investments of \$30.4 million, capital assets, net, of \$10.7 million, inventories and other assets of \$918 thousand, other noncurrent assets of \$559 thousand, and notes receivable of \$538 thousand.

Deferred Outflows of Resources. Deferred outflows of resources totaled \$3.4 million, a decrease of \$1.0 million, which represents the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt. The System refunded General Receipts 2005 Notes Series A and General Receipts 2007 Notes Series A and B during fiscal year 2015.

Liabilities. As of June 30, 2022, the System's liabilities totaled \$823.8 million. Long-term debt (current and non-current), which consists of general receipts notes and note payable to the University, comprised the largest liability of \$501.9 million or 60.9% of total liabilities. Accounts payable and accrued liabilities totaled \$191.2 million or 23.2% of liabilities, while unearned revenue represented approximately \$37.4 million or 4.5% of liabilities. Lease liabilities totaled \$65.4 million or 7.9% of liabilities. Long-term liabilities, other accounted for \$27.9 million or 3.4% of liabilities and consisted primarily of unamortized bond premium.

Total liabilities decreased \$7.3 million or 0.9% as a result of decreases in unearned revenue of \$39.0 million, other long-term liabilities of \$6.6 million, and long-term debt of \$3.3 million. These decreases were offset by increases in lease liabilities of \$65.4 million due to GASB Statement No. 87 implementation in fiscal year 2022 and accounts payable and accrued expenses of \$698 thousand.

Deferred Inflows of Resources. The System is the residual principal and income beneficiary of an irrevocable trust that is held and controlled by external trustees. For the year ended June 30, 2022, the System received income from this trust of \$400. The market value of the irrevocable external trust assets as of June 30, 2022 was \$68 thousand.

Net Position. Net position as of June 30, 2022 totaled approximately \$2.60 billion, or 76.0% of total assets. Net investment in capital assets totaled \$597.0 million or 23.0% of total net position. Restricted net position totaled \$7.9 million or 0.3% of total net position. Unrestricted net position accounted for \$1.99 billion or 76.7% of total net position. Total net position increased \$397.5 million or 18.1%.

Restricted net position is subject to externally imposed restrictions governing its use. Although unrestricted net position is not subject to externally imposed stipulations, substantially all of the unrestricted net position has been internally designated for capital projects and working capital requirements.

Statement of Revenues, Expenses and Changes in Net Position

The Statement of Revenues, Expenses and Changes in Net Position is the System's income statement. It details how net position has fluctuated during the year ended June 30, 2022. This statement is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. All items that increase or decrease net position must 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 gifts and investment income to be classified as 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.

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

	2022	2021
OPERATING REVENUES		
Net patient service revenues	\$ 2,641,160	\$ 2,347,631
Sales and services	138,437	115,494
Management contract revenue	49,725	43,447
Total operating revenues	2,829,322	2,506,572
OPERATING EXPENSES		
Salaries and benefits	977,624	791,336
Supplies and purchased services	961,650	780,997
Other expenses	240,654	239,345
Depreciation and amortization	100,411	76,226
Management contract expenses	46,738	40,351
Total operating expenses	2,327,077	1,928,255
NET INCOME FROM CONTINUING OPERATIONS	502,245	578,317
NONOPERATING REVENUES (EXPENSES)		
American Rescue Plan	21,736	—
Provider Relief Fund	—	30,261
Additions to permanent endowments	195	51
Grants and gifts	6,366	4,385
Investment income (loss)	(23,421)	104,354
Interest on capital asset-related debt	(20,479)	(17,799)
Transfers to the University of Kentucky	(50,188)	(195,859)
Other, net	(38,952)	(10,577)
Total nonoperating expenses	(104,743)	(85,184)
INCREASE IN NET POSITION	397,502	493,133
NET POSITION, beginning of year	2,201,531	1,708,398
NET POSITION, end of year	\$ 2,599,033	\$ 2,201,531

Operating Revenues

Total operating revenues were approximately \$2.83 billion for the year ended June 30, 2022, an increase of \$322.7 million or 12.9% over fiscal year 2021. The most significant source of operating revenue for the System was net patient service revenues of \$2.64 billion, an increase of \$293.5 million or 12.5% in fiscal year 2022 over 2021.

Inpatient net revenue, including bad debt, increased \$162.7 million or 13.6% over prior year. The primary driver of the increase was prior years' adjustments of \$49.9 million, including prior year Disproportionate Share Hospital revenue. Directed Payments also increased \$22.8 million due to increases in Medicaid eligible patients and the average commercial rate. In addition, there was an increase in patient discharges of 861 resulting in a \$90.0 million increase in inpatient net revenue.

Directed Payments are the difference between the System's average commercial rate and the rates Medicaid Managed Care Organizations pay for healthcare services. The payments are applicable to both inpatient and outpatient hospital services. A per day and per visit gap has been calculated and is applied to Medicaid Managed Care volume.

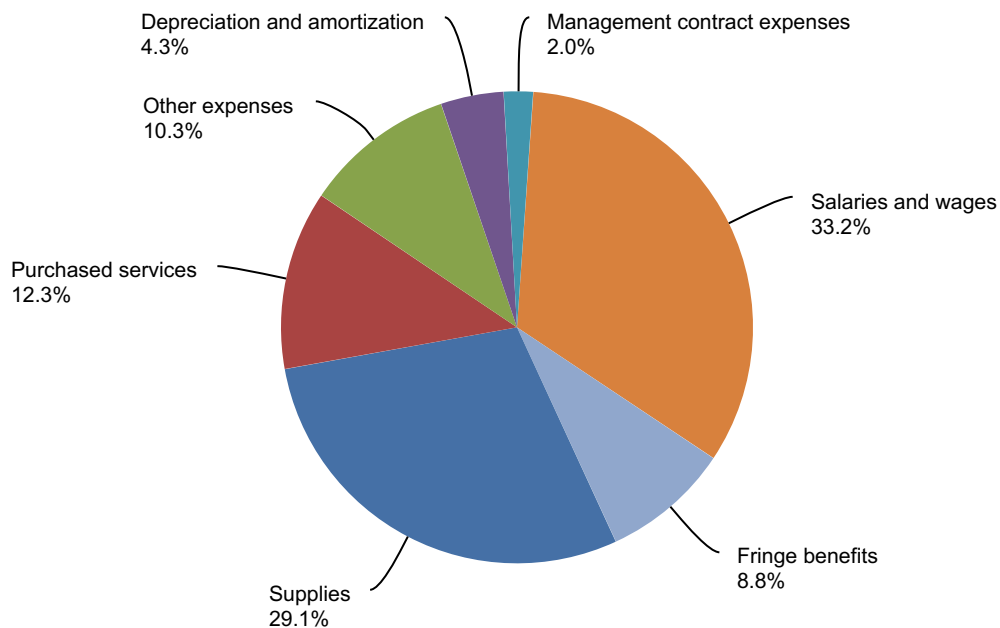
Surgery Blue had a net patient revenue increase over last year of \$3.5 million due to increased volume and patient mix.

Outpatient net revenue, including bad debt, increased by \$170.2 million or 16.2% over prior year. Increased outpatient activity due to the lifting of COVID restrictions in June 2021 resulted in a \$120.5 million increase in outpatient net revenue. Directed Payments also increased by \$49.7 million due to increases in Medicaid eligible patients and the average commercial rate.

The System was able to recognize \$554.9 million of Directed Payments revenue during the current fiscal year.

Bad debt provision decreased by \$5.7 million or 7.2% versus the prior year driven by the payer mix of covered individuals and the System has seen fewer accounts referred to bad debt over the prior year.

TOTAL OPERATING EXPENSES



Operating Expenses

Total operating expenses, including \$100.4 million of depreciation and amortization, were \$2.33 billion, an increase of \$398.8 million or 20.7% over the prior year.

Salaries and wages increased \$138.1 million over the prior fiscal year. The increase in salaries and wages was driven by a full-time equivalent (FTE) increase of 2,100, a 18.1% increase over prior year. The majority of this increase, 1,547 FTEs, was related to patient services due to volume of increases of patient services demand. Fringe benefits increased \$48.1 million or 30.9% primarily due to resuming employer retirement contributions from 5% to 10% in fiscal year 2022 and an increase of new FTEs of 2,100 in fiscal year 2022.

Supplies expenses increased \$72.0 million or 11.9% primarily due to increases in drugs, antibiotics, variable hospital supplies, and an increase in the outpatient population. Purchased services increased \$108.7 million or 61.5% primarily due to the increase in contract labor expenses. Other expenses decreased \$1.3 million or 0.5% primarily due to decreases in leases, maintenance, temporary services, and security services.

Nonoperating Revenues (Expenses)

Total net nonoperating expenses were \$54.6 million in fiscal year 2022 compared to \$110.7 million in total nonoperating revenues during the prior fiscal year, a decrease of \$165.2 million. This decrease was mainly due to a decrease in investment income (loss) of \$127.8 million because of the capital market downturn, an increase in other nonoperating expenses of \$30.2 million primarily due to King's Daughters Health System Directed Payments match, a decrease in COVID-19 federal funding of \$8.5 million, and an increase in interest expense of \$2.7 million. These were offset by an increase of \$1.9 million in gain on disposal of capital assets, an increase of \$1.2 million in capital gifts, and an increase of \$810 thousand in gifts and non-exchange grants.

Transfers to the University of Kentucky were \$50.2 million in fiscal year 2022 compared to \$195.9 million in fiscal year 2021 primarily because of a decrease in noncapital transfers of \$126.6 million. The decrease is due to the restructuring and funding of the Medical Group. In addition, there was an decrease in transfers to the University of Kentucky for capital purposes of \$19.1 million, primarily due to a \$25.0 million transfer for the College of Medicine health education building construction in fiscal year 2021.

Statement of Cash Flows

The Statement of Cash Flows details how cash has increased or decreased during the year ended June 30, 2022, with comparative financial information for the year ended June 30, 2021. It classifies the sources and uses of cash into the following categories:

- Operating activities
- Noncapital financing activities
- Capital and related financing activities
- Investing activities

Cash flows associated with the System'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 System during the year that will allow financial statement readers to assess the System's:

- Ability to generate future net cash flows
- Ability to meet obligations as they become due
- Possible need for external financing

Condensed Statements of Cash Flows (in thousands)

	2022	2021
CASH PROVIDED (USED) BY:		
Operating activities	\$ 327,585	\$ 529,403
Noncapital financing activities	(58,469)	(170,896)
Capital and related financing activities	(149,306)	(218,777)
Investing activities	7,017	5,587
Net increase in cash and cash equivalents	126,827	145,317
CASH AND CASH EQUIVALENTS, beginning of year	1,027,225	881,908
CASH AND CASH EQUIVALENTS, end of year	\$ 1,154,052	\$ 1,027,225

2022. The major sources of cash included in operating activities were net patient service revenues of \$2.38 billion, sales and services of \$138.4 million, and management contract services of \$46.8 million. Cash

payments for operating activities were \$1.22 billion to vendors, \$977.1 million to employees for salaries, wages and fringe benefits, and \$46.3 million for management contract services.

Cash used by noncapital financing consists of transfers to the University of Kentucky for noncapital purposes of \$48.9 million, and other financing payments of \$38.8 million. This was offset by an inflow of cash from the American Rescue Plan of \$21.7 million, gifts of \$6.7 million, and payments on loans from University departmental units of \$547 thousand.

Cash used by capital and related financing activities included principal and interest payments on long-term obligations and lease payables of \$62.3 million, purchases of capital assets of \$77.6 million, transfers to the University for capital purposes of \$5.2 million, and other capital and related financing payments of \$4.2 million.

Investing activities included proceeds from sales and maturities of investments of \$195.8 million and interest and dividends of \$17.1 million. Cash of \$205.9 million was used to purchase investments.

Key Ratios

The following table shows key liquidity and capital ratios for fiscal years 2022 and 2021:

	<u>2022</u>	<u>2021</u>
Days cash on hand	188	202
Days of revenue in accounts receivable	59	41
Debt service coverage (times)	11.2	13.1

Days cash on hand decreased to 188 days in fiscal year 2022 from 202 days in fiscal year 2021. Days cash on hand measures the average number of days' expenses the System maintains in cash. In addition, the System has access to working capital from the University and quasi-endowment investments of \$383.9 million.

The days of revenue in accounts receivable measures the average number of days it takes to collect accounts receivable. In fiscal year 2022, days in accounts receivable were 59 compared to 41 days in fiscal year 2021. Net accounts receivable increased by \$164.6 million from fiscal year 2021 to fiscal year 2022, which contributed to the increase in days in accounts receivable.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The System's ratio for fiscal year 2022 is 11.2 versus 13.1 in fiscal year 2021 due to the decrease in change in net position in fiscal year 2022 compared to fiscal year 2021.

Capital and Lease Asset and Debt Administration

Capital Assets. Capital assets, net of accumulated depreciation, totaled approximately \$1.13 billion at June 30, 2022, a net decrease of \$10.7 million over the prior year. Significant changes in capital assets during fiscal year 2022 included (in millions):

Land, buildings and structures, net additions	\$ 61.9
Equipment and vehicles, net additions	8.1
Capitalized software deletions	(0.9)
Artwork	0.2
Construction in process, net deletions	(9.9)
Increase in accumulated depreciation, net	<u>(70.1)</u>
Total	<u>\$ (10.7)</u>

Lease Assets. Lease assets, net of accumulated amortization, totaled approximately \$67.6 million at June 30, 2022, a net increase of \$1.8 million over July 1, 2021. Significant changes in lease assets during fiscal year 2022 included (in millions):

Lease land, buildings and structures, net additions	\$ 11.5
Lease equipment, net additions	3.6
Increase in lease accumulated amortization, net	<u>(13.3)</u>
Total	<u>\$ 1.8</u>

GASB statement No. 87 was adopted during fiscal year 2022 resulting in recognition of lease assets of \$65.8 million for lessee contracts as of July 1, 2021.

Debt. As of June 30, 2022, the System had \$469.7 million in general receipts project notes outstanding and a \$3.4 million loan due to the University; \$27.9 million is included in current liabilities with the remainder in long-term. On February 28, 2019, approximately \$8.4 million of the Surgery Blue promissory note was issued at a variable interest rate between 3.2% and 4.5%. The note was issued for the purpose of funding construction and development of Lexington Surgery Center projects. This note is a multi-draw term loan payable in full upon the maturity date and upon the terms and conditions provided in the promissory note. As of June 30, 2022, the promissory note was \$7.7 million.

As of June 30, 2022, the System had lease liabilities of \$65.4 million.

Economic Factors Impacting Future Periods

The following are known facts and circumstances that will affect future financial results:

- For the seventh consecutive year, UK HealthCare is ranked as the No. 1 hospital in Kentucky in the 2022-23 Best Hospitals rankings and ratings from U.S. News & World Report. Annual inpatient discharges from UK's hospitals are expected to exceed 40,500 for fiscal year 2023, an increase of over 18% in the last 10 years.
- Markey Cancer Center, Kentucky's only NCI-designated cancer center, was ranked No. 33 in the U.S. News Top 50 national ranking for cancer care. This makes the sixth consecutive year Markey has been ranked in the Top 50. In support of Markey Cancer Center's mission to increase access for Kentucky's most complex patients, in December of 2021, the University of Kentucky Board of Trustees approved a purchase agreement to acquire residential parcels across from UK Albert B. Chandler Hospital for the construction of a new outpatient cancer treatment center and advanced ambulatory complex. The design phase of the capital project was approved by the UK Board of Trustees' health care committee in May 2021. The proposed complex – with an estimated 260,000 square feet for cancer services – includes space for other advanced ambulatory (outpatient) clinics and structured parking as well as space for services such as outpatient operating rooms, procedures rooms, diagnostics and imaging services, pharmacy and lab services and room for meetings and support services.
- In June of 2022, UK HealthCare announced plans to enter a purchase agreement to initially acquire approximately 27 acres of property in the Hamburg development along US Interstate I-75—noted as a fast-growing area of the Bluegrass region.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENT OF NET POSITION (in thousands)
JUNE 30, 2022

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

Current Assets

Cash and cash equivalents	\$ 1,082,170
Accounts receivable, net (less allowance for doubtful accounts of \$65,646)	428,810
Inventories and other assets	61,240
Estimated third-party payer settlements	190,200
Notes receivable	2,890
Total current assets	<u>1,765,310</u>

Noncurrent Assets

Restricted cash and cash equivalents	71,882
Long-term investments	380,111
Capital assets, net	1,129,173
Lease assets, net	67,640
Notes receivable	1,501
Other assets	3,918
Total noncurrent assets	<u>1,654,225</u>

Total assets 3,419,535

Deferred Outflows of Resources

Total assets and deferred outflows of resources 3,422,908

LIABILITIES AND DEFERRED INFLOWS OF RESOURCES

Current Liabilities

Accounts payable and accrued liabilities	191,232
Unearned revenue	37,407
Long-term debt - current portion	27,850
Lease liabilities - current portion	16,650
Total current liabilities	<u>273,139</u>

Noncurrent Liabilities

Long-term liabilities - other	27,896
Long-term liabilities - debt	474,059
Lease liabilities	48,713
Total noncurrent liabilities	<u>550,668</u>
Total liabilities	<u>823,807</u>

Deferred Inflows of Resources

Total liabilities and deferred inflows of resources 823,875

NET POSITION

Net investment in capital assets

597,024

Restricted

Nonexpendable-other	<u>1,862</u>
Expendable	
Capital projects	1,861
Other	4,183
Total restricted expendable	<u>6,044</u>
Total restricted	<u>7,906</u>

Unrestricted

1,994,103

Total net position \$ 2,599,033

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (in thousands)
FOR THE YEAR ENDED JUNE 30, 2022

OPERATING REVENUES

Net patient service revenues, less provision for doubtful accounts of \$73,215	\$ 2,641,160
Sales and services	138,437
Management contract revenue	49,725
Total operating revenues	<u>2,829,322</u>

OPERATING EXPENSES

Salaries and wages	773,491
Fringe benefits	204,133
Supplies	676,102
Purchased services	285,548
Other expenses	240,654
Depreciation and amortization	100,411
Management contract expenses	46,738
Total operating expenses	<u>2,327,077</u>
Net income from continuing operations	<u>502,245</u>

NONOPERATING REVENUES (EXPENSES)

American Rescue Plan	21,736
Additions to permanent endowments	195
Gifts and non-exchange grants	4,676
Capital gifts	1,690
Investment loss	(23,421)
Interest on capital asset-related debt	(20,479)
Gain on disposal of capital assets	413
Other, net	(39,365)
Net nonoperating expenses	<u>(54,555)</u>
Net income before other revenues, expenses, gains or losses	<u>447,690</u>
Transfers to the University of Kentucky for noncapital purposes	(48,884)
Transfers to the University of Kentucky for capital purposes	(1,304)
Total other expenses	<u>(50,188)</u>
INCREASE IN NET POSITION	397,502
NET POSITION, beginning of year	2,201,531
NET POSITION, end of year	<u>\$ 2,599,033</u>

See notes to financial statements.

**UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENT OF CASH FLOWS (in thousands)
FOR THE YEAR ENDED JUNE 30, 2022**

CASH FLOWS FROM OPERATING ACTIVITIES

Net patient service revenues	\$ 2,379,304
Sales and services	138,366
Management contract services	46,764
Payments to vendors and contractors	(1,215,024)
Salaries, wages and fringe benefits	(977,062)
Payments on management contract services	(46,292)
Payments on short-term leases	(598)
Other receipts	2,127
Net cash provided by operating activities	<u>327,585</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

American Rescue Plan	21,736
Gifts	6,694
Additions to permanent endowments	195
Payments on loans from University of Kentucky departmental units	547
Transfers to the University of Kentucky for noncapital purposes	(48,884)
Other financing payments	(38,757)
Net cash used by noncapital financing activities	<u>(58,469)</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Purchases of capital assets	(77,626)
Principal payments - long-term obligations	(27,339)
Interest payments - long-term obligations	(17,476)
Principal payments - lease payable	(16,173)
Interest payments - lease payable	(1,272)
Other capital and related financing payments	(4,185)
Transfers to the University of Kentucky for capital purposes	(5,235)
Net cash used by capital and related financing activities	<u>(149,306)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from sales and maturities of investments	195,841
Interest and dividends on investments	17,104
Purchase of investments	(205,928)
Net cash provided by investing activities	<u>7,017</u>

NET INCREASE IN CASH AND CASH EQUIVALENTS

CASH AND CASH EQUIVALENTS, beginning of year	<u>1,027,225</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 1,154,052</u>

**UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENT OF CASH FLOWS (in thousands)
FOR THE YEAR ENDED JUNE 30, 2022**

Reconciliation of net income from continuing operations

to net cash provided by operating activities:

Net income from continuing operations	\$	502,245
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization		100,440
Write off of principal note receivable		835
Provision for doubtful accounts		(73,215)
Change in assets and liabilities:		
Accounts receivable		(91,402)
Inventories and other		917
Estimated third-party payer settlements receivable and payable		(75,574)
Other assets		(629)
Accounts payable and accrued liabilities		3,348
Unearned revenue		(39,032)
Long-term liabilities		(348)
Net cash provided by operating activities	\$	<u>327,585</u>

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:

Transfer of capital assets from UK	\$	3,932
Capital lease additions by Lexington Surgery Center	\$	932
Capital asset change in accounts payable and long-term liabilities - other	\$	(5,667)
Amortized bond premium	\$	3,393
Amortized difference between reacquisition price and net carrying amount of refunded debt	\$	1,030
Investment unrealized losses	\$	(40,525)
Lease obligation incurred for lease assets	\$	15,090

See notes to financial statements.

**UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2022**

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The UK HealthCare Hospital System (the System) is an organizational unit of the University of Kentucky (the University) which 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 System include Albert B. Chandler University Hospital including Kentucky Children's Hospital (collectively Chandler); UK HealthCare Good Samaritan Hospital (Good Samaritan); Kentucky Healthcare Enterprise, Inc., a wholly owned for-profit subsidiary, which has no balances or transactions as of and for the year ended June 30, 2022; Beyond Blue Corporation, a wholly owned non-profit subsidiary; Royal Blue, LLC, a wholly owned for-profit subsidiary that manages the joint venture between the System and Kings Daughter Health System that began on April 1, 2021. Surgery Blue, LLC, a wholly owned for-profit subsidiary and its for-profit subsidiary, Surgery Center of Lexington, LLC (SCL)(51% ownership). SCL has a calendar-year basis fiscal year from January 1 through December 31. Therefore, the financial statements of Surgery Center of Lexington, LLC as of December 31, 2021 are included in the System's financial statements as of June 30, 2022.

The System provides inpatient, outpatient, and emergency care services for residents of the Commonwealth.

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 and lease assets, net of accumulated depreciation and amortization 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 it be maintained permanently by the System.
Expendable - Net position whose use by the System is subject to externally imposed stipulations that can be fulfilled by actions of the System pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net position whose use by the System is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the University's 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 System'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. The System reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*. 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 System considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. The System also considers investments held in the Commonwealth's investment pools to be cash equivalents.

Noncurrent cash and cash equivalents include the System's plant funds allocated for capital projects, with the exception of unrestricted renewal and replacement cash, which is included in current cash and cash equivalents, and endowment fund cash pending transfer to the custodian for investment. Cash and cash equivalents held by the University's endowment fund managers are included in long-term investments.

Accounts Receivable. The System reports patient accounts receivable for services rendered at net realizable amounts from third-party payers and others. The System provides an allowance for doubtful accounts 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.

Long-term Investments. The System's endowment investments are administered as part of the University's pooled endowment funds. All endowments are managed in a consolidated investment pool which consists of more than 2,500 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 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.

Pooled Endowment 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 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 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.

The adopted spending policy is 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 3.5%, and not more than five percent, of the current endowment market value.

The University also utilized an endowment management fee to support internal management and fundraising costs related to the endowment. For the year ended June 30, 2022, the University's annual endowment management fee was 0.90%.

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.

For the year ended June 30, 2022, management elected to retain the spending distribution in the quasi-endowment and the amount available for spending in accordance with the University's endowment spending policy was \$12.8 million.

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

Equipment with a unit cost of \$5 thousand and having an estimated useful life of greater than one year is capitalized. Institutional software costing more than \$400 thousand is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings, 10 - 25 years for land and building improvements and infrastructure, 3 - 20 years for equipment and vehicles and 10 years for capitalized software.

Title to all capital assets of the System belongs to the University. The financial information relating to capital assets represents assets that the System occupies and uses. Transfer of capital assets to/from the University represents changes in control of individual assets within divisions of the University from one period to another.

Lease Assets. Lease assets are recorded at the initial measurement of the lease liability, plus payments made at or before the commencement of the lease term, less any lease incentive received from the lessor at or before the commencement of the lease term, plus initial direct costs that are ancillary to place the asset into service. Lease assets are amortized on a straight-line basis over the shorter of the lease term or the useful life of the underlying asset. Lease assets are reported under various assets categories.

Capital and Lease Assets Impairment. The System evaluates capital and lease assets for impairment whenever events or circumstances indicate a significant, unexpected decline in the service utility of a capital or lease asset has occurred. If a capital or lease asset is tested for impairment and the magnitude of the decline in service utility is significant and unexpected, the accumulated depreciation or accumulated amortization will be accelerated. The amount of the impairment loss will be recorded as the net book value divided proportionately over its remaining years of useful life. No capital or lease asset impairment was recognized during the year ended June 30, 2022.

Deferred Outflows of Resources. A deferred outflow of resources is a loss in net position by the System that is applicable to a future reporting period. Deferred outflows of resources are reported in the statement of net position, but are not recognized in the financial statements as expense until in the related period. Deferred outflows of resources of \$3.4 million as of June 30, 2022 consisted of the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt. The System issued General Receipts 2014 Bonds Series D to refund General Receipts 2005 Notes Series A which was originally issued to fund the construction of the patient care facility. General Receipts Notes 2007 Series A and B originally issued to fund construction of the patient care facility were refunded by the General Receipts 2015 Bond Series B.

Unearned Revenue. Unearned revenue consists of funds generated from the Kentucky AIDS Drug Assistance Program (KADAP) to be used for allowable costs within the program, and other unearned amounts. KADAP is governed by the Commonwealth Department for Public Health and administered by the System. The funds are to support the operations of the KADAP Income Reinvestment Program.

Compensated Absences. The amount of vacation leave earned but not taken by employees at June 30, 2022 is recorded as a liability by the System. Temporary disability leave payable upon termination under the University's payout policy is also recorded as a liability on the University's financial statements. 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.

Deferred Inflows of Resources. A deferred inflow of resources is a gain in net position by the System that is applicable to a future reporting period. Deferred inflows of resources are reported in the Statement of Net Position but are not recognized in the financial statements as revenue until in the related period. Deferred inflows of resources of \$68 thousand as of June 30, 2022 consisted of the beneficial interest from an irrevocable external trust that the system will receive in future years.

Net Patient Service Revenues. Net patient service 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 and include a provision 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 non-acute 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 29% and 28%, respectively, of the System's net patient service revenues before the provision for doubtful accounts for the year ended June 30, 2022. 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. With the impact of the COVID-19 pandemic and unemployment, more Kentuckians applied and received presumptive Medicaid. These changes have an impact on Medicaid uninsured payments. Prior year audits were completed and the System was able to recognize \$51.5 million of Medicaid Disproportionate Share Hospital revenue and other settlements during fiscal year 2022. The calculation methodology for supplemental payments was adjusted during fiscal year 2020 and is now referred to as Directed Payments. These new payments replace the Medicaid Managed Care Organization's portion of Intensity Operating Allowance and Physician Supplemental Payments. The Directed Payments are the difference between the System's average commercial rate and the rates Medicaid Managed Care Organizations pay for healthcare services. The payments are applicable to both inpatient and outpatient hospital services. A per day and per visit gap has been calculated and is applied to Medicaid Managed Care volume. The program is based upon data two years in arrears. The payments are based upon two components: access and quality. For fiscal year 2022, access is 90% of the program and quality is 10%. The Commonwealth withholds the quality component as well as an additional 5% for reconciliation, which occurs 14 months following the end of the first quarter, i.e., November 2022 for July through September 2021. A receivable for these dollars has been applied to the third party liability account for fiscal year 2022. Directed Payments of \$554.9 million was recognized in net patient service revenue in fiscal year 2022. The Department of Medicaid Services will be refunding the 5% withhold in the near future thus relieving this receivable.

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.

Management Contract Revenue. The System entered into a contract with the Kentucky Cabinet for Health and Family Services to manage Eastern State Hospital (ESH) and Central Kentucky Recovery Center (CKRC). Under the contract the System is reimbursed 100% of the related operating expenses up to a limit of \$37.3 million, and \$2.2 million, for ESH and CKRC, respectively. The System also receives an eight percent management fee. The initial contract term was August 13, 2013 to June 30, 2014 with the option to renew the contract for two additional one-year terms. Subsequent to year end, the contract was renewed for the period of July 1, 2022 to June 30, 2023 with substantially the same terms.

Charity Care. 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. The amount of charges forgone for services and supplies furnished under the System's charity care policy aggregated to approximately \$54.4 million in fiscal year 2022. The costs of charity care provided under the System's charity care policy were \$15.5 million for the year ended June 30, 2022. The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross uncompensated charges.

The American Rescue Plan Act (ARP). The American Rescue Plan is a \$1.9 trillion economic stimulus bill passed by Congress and signed into law by President Joe Biden on March 11, 2021 to speed up the country's recovery from the economic and health effects of the COVID-19 pandemic and the ongoing recession. The American Rescue Plan Act of 2021 is designed to facilitate the United States' recovery from the devastating economic and health effects of the COVID-19 pandemic and to provide additional relief to address the continued impact of the pandemic on the economy, public health, state and local governments, individuals, and businesses. Based on the ARP fund, the federal government distributed direct payments through the APR rural payments to the System in the amount of \$21.7 million in fiscal year 2022. The System is accounting for such payments as voluntary nonexchange transactions. Revenue is recognized when all eligibility requirements have been met. These payments are recorded as nonoperating revenue – ARP fund in the System's Statement of Revenues, Expenses and Changes in Net Position. ARP fund, if used within the terms and conditions of the program, does not need to be repaid to the federal government. The recipient is required to use it to prevent, prepare for, and respond to COVID-19, and that the payment shall reimburse only for healthcare-related expenses or lost revenues that are attributable to COVID-19. Appropriate expenses include healthcare-related expenses or lost revenue due to the coronavirus, which includes prevention, preparation, training, reporting, treatment, and declined services. The ARP fund is subject to government oversight, including potential audits.

Income Taxes. The University, of which the System is an organizational unit, 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.

Restricted Asset Spending Policy. The System'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 System 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 System's revenues and expenses are from exchange transactions. Certain revenues relied upon for operations, such as gifts and investment income, are recorded as non-operating revenues, in accordance with GASB Statement No. 35.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make 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 contractual allowances, allowances for doubtful accounts, estimated third-party payer settlements and estimated medical claims payable.

Adoption of GASB Statement No. 87. In June 2017, GASB issued Statement No. 87, Leases, which provided guidance regarding lease accounting. It establishes a single model for lease accounting based on the foundational principle that a lease is financing of the right to use an underlying asset. It requires the System to recognize lease liabilities and the intangible right-to-use lease assets as lessee, and lease receivables and deferred inflow of resources as lessor. The provisions of the statement were effective for fiscal years beginning after December 15, 2019 (fiscal year 2021). Due to the COVID-19 pandemic, GASB issued Statement No. 95, *Postponement of the Effective Date of Certain Authoritative Guidance*, extending the provisions of this statement by 18 months to fiscal year 2022.

GASB Statement No. 87 was adopted during fiscal year 2022 resulting in recognition of lease assets of \$65.8 million, lease liabilities of \$66.4 million for lessee contracts, which were reported at present value using the University's incremental borrowing rate unless otherwise noted in the contract.

Adoption of GASB Statement No. 89. In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the end of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. GASB Statement No. 89 was adopted during fiscal year 2022, Interest cost incurred before the end of a construction period is no longer included in the historical cost of capital assets in a business-type activity or enterprise fund. There was no impact to net position as of July 1, 2021.

Recent Accounting Pronouncements. As of June 30, 2022, the GASB has issued the following applicable statements to the System but are not yet implemented.

- GASB Statement No. 91, *Conduit Debt Obligations*, issued May 2019. The provisions of this statement are effective for fiscal years beginning after December 15, 2021 (fiscal year 2023). This statement provides a single method of reporting conduit debt obligations by issuers and eliminates diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. The System has determined GASB Statement No. 91 will have no material impact on its financial statements.
- GASB Statement No. 94, *Accounting for Public-private and Public-public Partnership Arrangements*, issued April 20, 2020. The provisions of this statement are effective for the fiscal year beginning after June 15, 2022 (fiscal year 2023). This statement provides guidance on accounting and financial reporting for availability payment arrangements (APAs). It defines an APA as an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining or operating an underlying nonfinancial asset for a period in an exchange or exchange-like transaction. The System has determined GASB Statement No. 94 will not have a material impact on its financial statement.
- GASB Statement No. 96, *Accounting for Subscription-based Information Technology Arrangements*, issued May, 2020. The provisions of this statement are effective for the fiscal year beginning after June 15, 2022 (fiscal year 2023). This statement provides guidance on accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users. This statement requires to recognize a right-to-use subscription asses-an intangible asset-and corresponding

subscription liability. The System is yet to determine the impact GASB Statement No. 96 will have on its financial statements.

- GASB Statement No. 101, *Compensated Absences*, issued June 2022. The provisions of this statement are effective for fiscal years beginning after December 15, 2023 (fiscal year 2025). It provides guidance for measuring liability for leave that has not been used, generally using an employee's pay rate as of the date of the financial statement. A liability for leave that has been used but not yet paid or settled should be measured at the amount of the cash payment or noncash settlement to be made. Certain salary-related payments that are directly and incrementally associated with payments for leave also should be included in the measurement of the liabilities. With respect to financial statement prepared using the current financial resources measurement focus, it requires that expenditures be recognized for the amount that normally would be liquidated with expendable available financial resources. The System has yet to determine the impact GASB Statement No. 101 will have on its financial statement.

2. DEPOSITS AND INVESTMENTS

The fair value of deposit and investment, by Statement of Net Position classification, at June 30, 2022 are as follows (in thousands):

Statement of Net Position classification:

Cash and cash equivalents	\$ 1,082,170
Restricted cash and cash equivalents	71,882
Total cash and cash equivalents	<u>1,154,052</u>
Long-term investments	380,111
Total Deposits and Investments	<u><u>\$ 1,534,163</u></u>

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

The System categorizes its fair value measurements within the fair value hierarchy. Certain investments are measured at fair value using net asset value per share (or its equivalent), practical expedient, amortized costs, or historical costs and therefore have not been classified in the fair value hierarchy. These investments have been included in the table below to permit reconciliation of the fair value hierarchy to the amounts presented in the Statement of Net Position.

The System has the following valuation measurements, by type, at June 30, 2022 (in thousands):

	Fair Value Measurement Using					Amortized or Historical Cost
	Total Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Measured at Fair Value	
Cash and cash equivalents	\$ 1,154,052	\$ —	\$ —	\$ —	\$ —	\$ 1,154,052
University's pooled endowment fund	380,111	—	—	380,111	380,111	—
Total deposits and investments	<u>\$ 1,534,163</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 380,111</u>	<u>\$ 380,111</u>	<u>\$ 1,154,052</u>

Where quoted market prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in level 2 of the valuation 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. 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, 2022.

The composition of the University's pooled endowment fund based upon fair value at June 30, 2022 is as follows:

Cash and cash equivalents	0.2 %
Diversifying strategies	14.9 %
Global equity - international	15.2 %
Global equity - private	21.6 %
Global equity - U.S.	20.3 %
Global fixed income - public fixed income	9.0 %
Global fixed income - private credit	3.3 %
Real assets - private	13.3 %
Real assets - public	2.2 %
Total	<u>100.0 %</u>

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

For purposes of investment management, the System'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 the 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 System'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 Statement 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 System 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, therefore 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 System 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 System'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 System's ownership interest (units) in the University's pooled endowment fund.

Concentrations of Credit Risk. The System'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 agency securities or other similar investments as provided by Kentucky Revised Statutes 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, 2022, the System had no investments in any one issuer that represented five percent or more 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 actively managed intermediate-term fixed income manager are limited to a duration that is within two years of the duration of the Barclays U.S. Intermediate 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 System's exposure to foreign currency risk derives from certain endowment investments of 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. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, as of June 30, 2022 are as follows (in thousands):

	Gross Receivable	Allowance	Net Receivable
Medicare, Medicaid and other third parties	\$ 472,535	\$ (55,357)	\$ 417,178
Private pay	21,374	(10,095)	11,279
Pledges receivable	547	(194)	353
Total	<u>\$ 494,456</u>	<u>\$ (65,646)</u>	<u>\$ 428,810</u>

The above pledges receivable are shown net of present value discount.

In accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the System is required to record operating and capital pledges as revenue when all eligibility requirements have been met. For the year ended June 30, 2022, the System recorded the discounted value of operating and capital pledges using a rate of two percent.

The System has recorded an allowance for uncollectible patient accounts receivable equal to 14.5% of patient accounts receivable as of June 30, 2022. A summary of the changes in the allowance for uncollectible patient accounts receivable is as follows:

Balance, beginning of year	\$ 60,812
Provision for doubtful accounts	73,215
Receivables charged off, net of recoveries	<u>(68,381)</u>
Balance, end of year	<u>\$ 65,646</u>

4. CAPITAL AND LEASE ASSETS, NET

Capital assets as of June 30, 2022 and capital asset activity for the year ended June 30, 2022 are summarized as follows (in thousands):

	Balance July 1, 2021	Additions	Deletions	Balance June 30, 2022
Land	\$ 31,406	\$ 12,052	\$ —	\$ 43,458
Non-depreciable land improvements	18,809	—	—	18,809
Depreciable land improvements	9,338	1	—	9,339
Buildings	1,079,322	43,902	—	1,123,224
Fixed equipment	52,132	5,929	—	58,061
Infrastructure	31,864	—	—	31,864
Equipment	372,991	25,852	18,044	380,799
Vehicles	1,683	438	146	1,975
Capitalized software	208,333	—	880	207,453
Artwork	3,003	205	—	3,208
Construction in process	26,972	15,171	25,089	17,054
Certificate of need	11,609	—	—	11,609
	<u>1,847,462</u>	<u>103,550</u>	<u>44,159</u>	<u>1,906,853</u>
<u>Accumulated Depreciation:</u>				
Depreciable land improvements	6,896	320	—	7,216
Buildings	327,871	29,546	—	357,417
Fixed equipment	30,878	3,800	—	34,678
Infrastructure	13,494	1,274	—	14,768
Equipment	243,494	34,443	16,938	260,999
Vehicles	1,022	296	145	1,173
Capitalized software	83,959	17,470	—	101,429
	<u>707,614</u>	<u>87,149</u>	<u>17,083</u>	<u>777,680</u>
Capital assets, net	<u>\$ 1,139,848</u>	<u>\$ 16,401</u>	<u>\$ 27,076</u>	<u>\$ 1,129,173</u>

Reductions to equipment and depreciation included equipment disposed by the Surgery Center of Lexington, LLC, of \$932 thousand for both cost and depreciation in fiscal year 2022.

At June 30, 2022, the System has commitments in construction projects in progress totaling approximately \$131.2 million in scope. The estimated cost to complete these projects was approximately \$115.0 million. Such construction is principally financed by the System's cash reserves and proceeds from the System general receipts bonds.

During fiscal year 2022, the System utilized capital financing to acquire various items of land and buildings. The net book value for capitalized land and buildings is \$46.3 million at June 30, 2022. The net book value for capitalized leased land, buildings and equipment for the Surgery Center of Lexington, LLC is recorded as \$13.1 million for the year ended June 30, 2022.

Lease assets as of June 30, 2022 and lease asset activity for the year ended June 30, 2022 are summarized as follows (in thousands):

	Balance July 1, 2021	Additions	Deletions	Balance June 30, 2022
Buildings	\$ 44,883	\$ 11,505	\$ —	\$ 56,388
Equipment	20,930	3,584	—	24,514
	<u>65,813</u>	<u>15,089</u>	<u>—</u>	<u>80,902</u>
<u>Accumulated amortization:</u>				
Buildings	—	10,883	—	10,883
Equipment	—	2,379	—	2,379
	<u>—</u>	<u>13,262</u>	<u>—</u>	<u>13,262</u>
Lease assets, net	<u>\$ 65,813</u>	<u>\$ 1,827</u>	<u>\$ —</u>	<u>\$ 67,640</u>

The System adopted GASB Statement No. 87 and recorded lease assets of \$65.8 million as of July 1, 2021.

5. NOTES RECEIVABLE

Notes receivable at June 30, 2022 are as follows (in thousands):

Non-interest bearing, unsecured receivable from UK College of Pharmacy	\$ 2,464
Non-interest bearing, unsecured receivable from UK College of Nursing	1,927
Total	<u>\$ 4,391</u>
Current portion	\$ 2,890
Noncurrent portion	1,501
Total	<u>\$ 4,391</u>

6. OTHER ASSETS

Other assets at June 30, 2022 are as follows (in thousands):

Amounts on deposit with trustee	\$ 65
Goodwill	2,150
Noncurrent portion of prepaid expenses	1,536
Pledges receivable noncurrent, net	167
Total	<u>\$ 3,918</u>

The amounts on deposit with the trustee represent cash equivalents, measured as a level 1 on the fair value hierarchy as discussed in note 2.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2022 are summarized as follows (in thousands):

Payable to vendors and contractors	\$ 100,476
Due to the University of Kentucky	9,662
Accrued expenses, including vacation leave	81,094
Total	<u>\$ 191,232</u>

8. LONG-TERM DEBT

Long-term debt as of June 30, 2022 are summarized as follows (in thousands):

	Balance July 1, 2021	Additions	Reductions	Balance June 30, 2022	Current Portion	Noncurrent Portion
General Receipts						
Project Notes	\$ 489,942	\$ —	\$ 20,269	\$ 469,673	\$ 21,239	\$ 448,434
Note Payable	8,537	—	799	7,738	822	6,916
Due to the University of Kentucky	6,750	—	3,356	3,394	3,394	—
Capital Financed Obligations	23,187	251	2,334	21,104	2,395	18,709
Total	<u>\$ 528,416</u>	<u>\$ 251</u>	<u>\$ 26,758</u>	<u>\$ 501,909</u>	<u>\$ 27,850</u>	<u>\$ 474,059</u>

Principal maturities and interest on long-term debt for the next five years and in subsequent five-year periods as of June 30, 2022 are as follows (in thousands):

	Principal	Interest	Total
2023	\$ 27,850	\$ 20,924	\$ 48,774
2024	25,610	19,655	45,265
2025	26,718	18,432	45,150
2026	27,842	17,235	45,077
2027	29,703	17,037	46,740
2028-2032	109,628	69,384	179,012
2033-2037	112,388	44,187	156,575
2038-2042	100,480	17,950	118,430
2043-2047	40,175	3,402	43,577
2048	1,515	27	1,542
Total	<u>\$ 501,909</u>	<u>\$ 228,233</u>	<u>\$ 730,142</u>

Bond premiums, which are included in current and noncurrent accrued liabilities, are amortized over the life of the bond using the effective interest method.

The general receipts project notes consist of bonds in the original amount of \$552.4 million dated November 24, 2009 through February 20, 2018, which bear interest at 2.34% to 3.65%. The bonds are payable in annual installments through June 30, 2048. The System is required to make semi-annual deposits of varying amounts to the debt service funds held by the trustees. The bonds are secured by pledged revenues of the University, which include the net revenues of the System.

On November 24, 2009, \$100.6 million of the University of Kentucky General Receipts 2009 Bonds Series B were issued at a net interest cost of 3.59%. These bonds were issued as Build America Bonds (BAB) as authorized under the American Recovery and Reinvestment Act of 2009. The System will receive an annual cash subsidy from the U.S. Treasury equal to 35% of the interest payable on the bonds. This subsidy, which was approximately \$1.6 million during fiscal year 2022, is included in gifts and non-exchange grants in the Statement 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, President Barack Obama signed an executive order on reducing the budgetary authority in accounts subject to sequestration. As a result, the BAB subsidy was reduced to 33% in fiscal year 2022.

On July 30, 2010, the System entered into an unsecured internal loan agreement with the University to acquire funding for construction of a suite of operating rooms in the patient care facility. Funds were transferred to the construction project as needed and will be repaid over a ten year period. Interest shall be charged based on the historical performance of the two-year U.S. Treasury note plus one percent. The total effective rate was 1.21% for interest payments in fiscal year 2022. The annual interest rate will be determined March 1 and be effective for the following fiscal year.

On February 28, 2019, \$8.4 million of the Surgery Blue promissory note was issued at a variable interest rate between 3.2% and 4.5%. This note was issued for the purpose of funding construction and development Lexington Surgery Center projects. This note is a multi-draw term loan payable in full upon the maturity date and upon the terms and conditions provided in the promissory note.

9. LEASE LIABILITIES

Lease liabilities as of June 30, 2022 are summarized as follows (in thousands):

	Balance July 1, 2021	Additions	Deletions	Balance June 30, 2022	Current Portion	Noncurrent Portion
Buildings	\$ 44,883	\$ 11,505	\$ 10,597	\$ 45,791	\$ 10,623	\$ 35,168
Equipment	21,563	3,585	5,576	19,572	6,027	13,545
	<u>\$ 66,446</u>	<u>\$ 15,090</u>	<u>\$ 16,173</u>	<u>\$ 65,363</u>	<u>\$ 16,650</u>	<u>\$ 48,713</u>

The System leases buildings and equipment, the terms of which expire in various years through 2030. The System adopted GASB Statement No. 87 and recorded lease liabilities of \$66.4 million as of July 1, 2021. The lease liabilities were reported at present value using the University's incremental borrowing rate unless otherwise noted in the contract term.

Principal and interest on lease obligations for the next five fiscal years and in subsequent five-year fiscal periods as of June 30, 2022, are as follows (in thousands):

	Principal	Interest	Total
2023	\$ 16,650	\$ 1,302	\$ 17,952
2024	13,646	958	14,604
2025	11,234	678	11,912
2026	10,608	446	11,054
2027-2030	13,225	322	13,547
Total	<u>\$ 65,363</u>	<u>\$ 3,706</u>	<u>\$ 69,069</u>

10. LONG-TERM LIABILITIES - OTHER

Other long-term liabilities as of June 30, 2022 are summarized as follows (in thousands):

	Balance July 1, 2021	Additions	Reductions	Balance June 30, 2022
Refundable deposits	\$ 10	\$ —	\$ 13	\$ (3)
Workers compensation	181	26	—	207
Construction retainage	25	1,124	587	562
Unamortized bond premium	22,173	—	3,393	18,780
Capital payable	12,152	—	3,802	8,350
Long-term liabilities - other	<u>\$ 34,541</u>	<u>\$ 1,150</u>	<u>\$ 7,795</u>	<u>\$ 27,896</u>

11. DESIGNATIONS OF UNRESTRICTED NET POSITION

Unrestricted net position is designated for specific purposes by action of the University's Board of Trustees or management or may otherwise be limited by contractual obligations. Commitments for the use of unrestricted net position at June 30, 2022 are as follows (in thousands):

Working capital requirements	\$ 1,470,130
Future capital expenditures	523,973
Total	<u>\$ 1,994,103</u>

12. INVESTMENT INCOME (LOSS)

Components of investment income (loss) for the year ended June 30, 2022 are as follows (in thousands):

Interest and dividends earned on endowment investments	\$ 5,610
Realized and unrealized losses on endowment investments	(30,417)
Interest and dividends on cash and non-endowment investments	(201)
Realized and unrealized gains on non-endowment investments	1,587
Total	<u>\$ (23,421)</u>

13. PLEDGED REVENUES

The University has substantially pledged all of the unrestricted operating and nonoperating revenues, including the System revenues, to repay the general receipts bonds and notes issued from 2009 to 2018. Only the General Receipts 2009 Bonds Series B, General Receipts Bonds 2014 Series D, General Receipts Bonds 2015 Series A and B and General Receipts 2018 Bonds Series A are reflected as the System debt. Proceeds from the bonds and notes provided funding for the construction of the patient care facility and the refunding of previously issued notes. The bonds and notes are payable from unrestricted operating and nonoperating revenues and are payable through 2048. Annual principal and interest payments on bonds and notes are expected to require less than three percent of pledged revenues. The total principal and interest remaining to be paid on the bonds and notes is \$690.8 million as of June 30, 2022. Principal and interest paid for the year ended June 30, 2022 was \$39.3 million.

14. RETIREMENT PLANS

Regular full-time employees of the System are participants in the University of Kentucky Retirement Plan, a defined contribution plan. System employees participate in one of the following three groups of the University of Kentucky Retirement Plan:

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.

Participation in these groups of the University of Kentucky Retirement Plan is mandatory for all regular full-time employees age 30 and older. Participation is voluntary until age 30. The System contributes 10% and each employee contributes five percent of eligible compensation. 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 three years.

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

- Teachers Insurance and Annuity Association (TIAA)
- Fidelity Investments Institutional Services Company

In addition to retirement benefits provided from the group retirement plan, the University provides supplemental retirement income benefits to certain eligible employees of the University.

The total contributions charged to operations for the various retirement plans was approximately \$50.9 million for the year ended June 30, 2022. Employees contributed \$25.5 million during fiscal year 2022. The payroll for employees covered by the retirement plans was \$509.1 million for fiscal year 2022.

15. 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. 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.

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. However, retirees must pay the greater of \$88 per month for fiscal year 2022 or 10% of total plan costs.

The University has established a trust fund to segregate plan assets, and the contribution requirements of plan members and the University are established and may be amended by the president of the University. The University contributed to the Other Postemployment Benefit trust based on a funding policy supported by an actuarial study in accordance with the parameters of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*.

As an organizational unit of the University, the System has recognized its share of the contribution in employee benefit costs and has no additional liability for this benefit as of June 30, 2022.

16. RISK MANAGEMENT

The University, of which the System is an organizational unit, 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 Commonwealth's 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 \$5 thousand and \$1.0 million per occurrence. Losses in excess of \$1.0 million are insured by commercial carriers up to \$1.5 billion per occurrence. Buildings and contents are insured at replacement cost. 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 thousand for any one person or \$350 thousand 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 fiscal year 2021 to 2022. Settlements have not exceeded insurance coverage during the past five 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 at June 30, 2022 is based on the requirements of GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, which requires that a liability for claims be recorded if it is probable that a liability has occurred and the amount of loss can be reasonably estimated. The liability includes an estimate for claims that have been incurred but not reported at June 30, 2022. All assets and liabilities related to medical malpractice are recorded in the financial records of the University and, accordingly, no assets or liabilities related to medical malpractice are recorded on the System's financial statements. However, the System does fund its required share of the actuarially determined medical malpractice expense.

The University is self-insured for the long-term disability income program and has established a 501(c)(9) trust for purposes of paying claims and establishing necessary reserves. The University currently plans to contribute to the trust based on an amount actuarially determined in accordance with the parameters of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. As an organizational unit of the University, the System has recognized its share of the contribution in employee benefit costs and has no additional liability for this benefit at June 30, 2022.

The University also self-insures certain employee benefits, including health insurance, worker's compensation and unemployment claims. The University has recorded an estimate for asserted claims as of June 30, 2022.

17. TRANSACTIONS WITH RELATED PARTIES

Due to the nature of the relationship of the System with the University, the System has substantial transactions with the University, including purchases of various supplies and services. Additionally, the University and its affiliates provide certain administrative support functions to the System. The System paid approximately \$23.8 million in fiscal year 2022 to the University as reimbursement for various educational and support functions. The System also recognized income from the University for providing medical services to employees under a capitation health plan. During 2022, the System received payments of approximately \$58.0 million from the University for the capitation health plan. Noncapital transfers between the System and the University were \$48.9 million for fiscal year 2022. In addition, capital transfers from the University were \$1.3 million for fiscal year 2022.

18. FUNDS HELD IN TRUST BY OTHERS

The System is the residual principal and income beneficiary of an irrevocable trust that is held and controlled by external trustees. For the year ended June 30, 2022, the System received income from this trust of approximately \$400. The market value of the irrevocable external trust assets as of June 30, 2022 was approximately \$68 thousand.

19. COMBINED STATEMENTS

The System and its blended component units' statements are summarized as follows for the year ended June 30, 2022:

UNIVERSITY OF KENTUCKY HEALTHCARE
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
COMBINED STATEMENT OF NET POSITION (in thousands)
AS OF JUNE 30, 2022

	University of Kentucky Healthcare	Surgery Blue, LLC	Beyond Blue Corporation	Eliminations	Total
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES					
Current Assets					
Cash and cash equivalents	\$ 1,073,998	\$ 2,211	\$ 5,961	\$ —	\$ 1,082,170
Accounts receivable, net (less allowance for doubtful accounts of \$65,646)	424,123	1,995	2,692	—	428,810
Inventories and other assets	61,137	103	—	—	61,240
Estimated third-party payor settlements	190,200	—	—	—	190,200
Notes receivable	2,890	—	—	—	2,890
Total current assets	<u>1,752,348</u>	<u>4,309</u>	<u>8,653</u>	<u>—</u>	<u>1,765,310</u>
Noncurrent Assets					
Restricted cash and cash equivalents	71,882	—	—	—	71,882
Equity in health care corporations	1,278	—	—	(1,278)	—
Long-term investments	382,195	—	—	(2,084)	380,111
Capital assets, net	1,116,093	13,080	—	—	1,129,173
Lease assets, net	67,640	—	—	—	67,640
Notes receivable	1,501	—	—	—	1,501
Other assets	1,776	2,142	—	—	3,918
Total noncurrent assets	<u>1,642,365</u>	<u>15,222</u>	<u>—</u>	<u>(3,362)</u>	<u>1,654,225</u>
Total assets	<u>3,394,713</u>	<u>19,531</u>	<u>8,653</u>	<u>(3,362)</u>	<u>3,419,535</u>
Deferred Outflows of Resources					
	<u>3,373</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>3,373</u>
Total assets and deferred outflows of resources	<u>3,398,086</u>	<u>19,531</u>	<u>8,653</u>	<u>(3,362)</u>	<u>3,422,908</u>
LIABILITIES AND DEFERRED INFLOWS OF RESOURCES					
Current Liabilities					
Accounts payable and accrued liabilities	189,852	1,244	136	—	191,232
Unearned revenue	37,394	13	—	—	37,407
Long-term debt - current portion	26,688	1,162	—	—	27,850
Lease liabilities - current portion	16,650	—	—	—	16,650
Total current liabilities	<u>270,584</u>	<u>2,419</u>	<u>136</u>	<u>—</u>	<u>273,139</u>
Noncurrent Liabilities					
Long-term liabilities - other	27,795	101	—	—	27,896
Long-term liabilities - debt	461,478	12,581	—	—	474,059
Lease liabilities	48,713	—	—	—	48,713
Total noncurrent liabilities	<u>537,986</u>	<u>12,682</u>	<u>—</u>	<u>—</u>	<u>550,668</u>
Total liabilities	<u>808,570</u>	<u>15,101</u>	<u>136</u>	<u>—</u>	<u>823,807</u>
Deferred Inflows of Resources					
	<u>68</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>68</u>
Total liabilities and deferred inflows of resources	<u>808,638</u>	<u>15,101</u>	<u>136</u>	<u>—</u>	<u>823,875</u>
NET POSITION					
Net investment in capital assets	<u>597,024</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>597,024</u>
Restricted					
Nonexpendable other	1,862	—	—	—	1,862
Expendable	6,044	—	—	—	6,044
Total restricted	<u>7,906</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>7,906</u>
Unrestricted	<u>1,984,518</u>	<u>4,430</u>	<u>8,517</u>	<u>(3,362)</u>	<u>1,994,103</u>
Total net position	<u>\$ 2,589,448</u>	<u>\$ 4,430</u>	<u>\$ 8,517</u>	<u>\$ (3,362)</u>	<u>\$ 2,599,033</u>

UNIVERSITY OF KENTUCKY HEALTHCARE
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (in thousands)
FOR THE YEAR ENDED JUNE 30, 2022

	University of Kentucky Healthcare	Surgery Blue, LLC	Beyond Blue Corporation	Eliminations	Total
OPERATING REVENUES					
Net patient service revenues, less provision for doubtful of accounts \$73,215	\$ 2,623,915	\$ 17,245	\$ —	\$ —	\$ 2,641,160
Sales and services	126,224	1,335	10,878	—	138,437
Management contract revenue	49,725	—	—	—	49,725
Total operating revenues	<u>2,799,864</u>	<u>18,580</u>	<u>10,878</u>	<u>—</u>	<u>2,829,322</u>
OPERATING EXPENSES					
Salaries and wages	769,541	3,883	67	—	773,491
Fringe benefits	203,299	834	—	—	204,133
Supplies	669,017	7,085	—	—	676,102
Purchased services	281,001	365	4,182	—	285,548
Other expenses	238,683	1,971	—	—	240,654
Depreciation and amortization	99,179	1,232	—	—	100,411
Management contract expenses	46,738	—	—	—	46,738
Total operating expenses	<u>2,307,458</u>	<u>15,370</u>	<u>4,249</u>	<u>—</u>	<u>2,327,077</u>
Net income from continuing operations	<u>492,406</u>	<u>3,210</u>	<u>6,629</u>	<u>—</u>	<u>502,245</u>
NONOPERATING REVENUES (EXPENSES)					
American Rescue Plan	21,736	—	—	—	21,736
Additions to permanent endowments	195	—	—	—	195
Gifts and non-exchange grants	4,676	—	—	—	4,676
Capital gifts	1,690	—	—	—	1,690
Investment income (loss)	(21,356)	19	—	(2,084)	(23,421)
Interest on capital asset-related debt	(19,854)	(625)	—	—	(20,479)
Loss on disposal of capital assets	413	—	—	—	413
Other, net	(38,340)	(1,025)	—	—	(39,365)
Net nonoperating revenues (expenses), net	<u>(50,840)</u>	<u>(1,631)</u>	<u>—</u>	<u>(2,084)</u>	<u>(54,555)</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>441,566</u>	<u>1,579</u>	<u>6,629</u>	<u>(2,084)</u>	<u>447,690</u>
Transfers to the University of Kentucky for noncapital purposes	(48,884)	—	—	—	(48,884)
Transfers from the University of Kentucky for capital purposes	(1,304)	—	—	—	(1,304)
Total other expenses	<u>(50,188)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(50,188)</u>
INCREASE (DECREASE) IN NET POSITION	<u>391,378</u>	<u>1,579</u>	<u>6,629</u>	<u>(2,084)</u>	<u>397,502</u>
NET POSITION, beginning of year	<u>2,198,070</u>	<u>2,851</u>	<u>1,888</u>	<u>(1,278)</u>	<u>2,201,531</u>
NET POSITION, end of year	<u>\$ 2,589,448</u>	<u>\$ 4,430</u>	<u>\$ 8,517</u>	<u>\$ (3,362)</u>	<u>\$ 2,599,033</u>

UNIVERSITY OF KENTUCKY HEALTHCARE
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
COMBINED STATEMENT OF CASH FLOWS (in thousands)
FOR THE YEAR ENDED JUNE 30, 2022

	University of Kentucky Healthcare	Surgery Blue, LLC	Beyond Blue Corporation	Eliminations	Total
CASH FLOWS FROM OPERATING ACTIVITIES					
Net patient service revenues	\$ 2,362,366	\$ 16,938	\$ —	\$ —	\$ 2,379,304
Sales and services	126,224	1,335	10,807	—	138,366
Management contract services	46,764	—	—	—	46,764
Payments to vendors and contractors	(1,201,890)	(9,688)	(4,251)	805	(1,215,024)
Salaries, wages and fringe benefits	(971,776)	(4,692)	(594)	—	(977,062)
Payments on management contract services	(46,292)	—	—	—	(46,292)
Payments on short-term leases	(598)	—	—	—	(598)
Other receipts (payments)	2,128	—	(1)	—	2,127
Net cash provided by operating activities	<u>316,926</u>	<u>3,893</u>	<u>5,961</u>	<u>805</u>	<u>327,585</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES					
American Rescue Plan	21,736	—	—	—	21,736
Gifts	6,694	—	—	—	6,694
Additions to permanent endowments	195	—	—	—	195
Payments on loans from University of Kentucky departmental units	547	—	—	—	547
Transfers to the University of Kentucky for noncapital purposes	(48,884)	—	—	—	(48,884)
Other financing payments	(37,723)	(1,034)	—	—	(38,757)
Net cash used by noncapital financing activities	<u>(57,435)</u>	<u>(1,034)</u>	<u>—</u>	<u>—</u>	<u>(58,469)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES					
Purchases of capital assets	(77,577)	(49)	—	—	(77,626)
Principal payments - long-term obligations	(26,172)	(1,167)	—	—	(27,339)
Interest payments - long-term obligations	(16,851)	(625)	—	—	(17,476)
Principal payments - lease payable	(16,173)	—	—	—	(16,173)
Interest payments - lease payable	(1,272)	—	—	—	(1,272)
Other capital and related financing payments	(4,185)	—	—	—	(4,185)
Transfers from the University of Kentucky for capital purposes	(5,235)	—	—	—	(5,235)
Net cash used by capital and related financing activities	<u>(147,465)</u>	<u>(1,841)</u>	<u>—</u>	<u>—</u>	<u>(149,306)</u>
CASH FLOWS FROM INVESTING ACTIVITIES					
Proceeds from sales and maturities of investments	195,841	—	—	—	195,841
Interest and dividends on investments	17,890	19	—	(805)	17,104
Purchase of investments	(205,928)	—	—	—	(205,928)
Net cash provided by investing activities	<u>7,803</u>	<u>19</u>	<u>—</u>	<u>(805)</u>	<u>7,017</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	<u>119,829</u>	<u>1,037</u>	<u>5,961</u>	<u>—</u>	<u>126,827</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>1,026,051</u>	<u>1,174</u>	<u>—</u>	<u>—</u>	<u>1,027,225</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 1,145,880</u>	<u>\$ 2,211</u>	<u>\$ 5,961</u>	<u>\$ —</u>	<u>\$ 1,154,052</u>



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