



UK University of
Kentucky

Central Kentucky Management Services, Inc.
2016 Financial Statements

University of Kentucky
Central Kentucky Management Services, Inc.
A Component Unit of the University of Kentucky
Financial Statements
Years Ended June 30, 2016 and 2015

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Independent Auditor's Report

Board of Directors
Central Kentucky Management Services, Inc.
Lexington, Kentucky

We have audited the accompanying basic financial statements, which are comprised of statements of net position as of June 30, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the basic financial statements, as listed in the table of contents, of Central Kentucky Management Services, Inc. (CKMS), a not-for-profit corporation affiliated with and a component unit of the University of Kentucky.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CKMS as of June 30, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Other Information

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

BKD, LLP

Louisville, Kentucky
October 3, 2016

Management's Discussion and Analysis

Central Kentucky Management Services, Inc.'s (CKMS) Management's Discussion and Analysis (MD&A) provides an overview of the financial position and activity of CKMS for the years ended June 30, 2016 and 2015. This discussion has been prepared by management and should be read in conjunction with the accompanying financial statements and the notes appearing in the report.

Financial Highlights

- Total assets increased \$287,517 or 16.5%. The most significant component of this change was an increase in cash and cash equivalents of \$943,690 offset by decreases of \$606,692 in due from the University of Kentucky and \$49,818 in capital assets, net (equipment).
- Total liabilities increased \$337,335 or 21.1%. This change was due to an increase of \$341,069 in accounts payable and accrued liabilities offset by a decrease of \$3,734 in the escrow account payable to the UK HealthCare Hospital System.
- Net position decreased \$49,818 or 36.4% to \$86,939.
- Operating revenues increased \$4,696,703 or 17.6% to \$31,404,728.
- Operating expenses increased \$4,687,926 or 17.5% to \$31,426,542.

Using the Financial Statements

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

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

The Statement of Net Position includes all assets, deferred outflows of resources, liabilities, and deferred inflows of resources. It is prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

The Statement of Revenues, Expenses and Changes in Net Position presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. GASB 35 requires investment income to be classified as nonoperating revenues. The utilization of long-lived assets, referred to as Capital Assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

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

Reporting Entity

Central Kentucky Management Services, Inc. (CKMS) provides collection services for the health care receivables of the University of Kentucky (the University) and its affiliated corporations. All commission revenues are received from these entities and the excess of revenues over expenses is distributed back to these entities. CKMS also provides staffing services to health care facilities for the University on a direct cost reimbursement basis.

CKMS is considered to be an affiliate and component unit of the University because the Board of Directors is appointed by the President of the University and the officers of CKMS are also officers of the University.

Condensed Financial Information

Statements of Net Position

| | 2016 | 2015 | 2014 |
|----------------------------------|--------------|--------------|------------|
| ASSETS | | | |
| Current assets | \$ 1,939,369 | \$ 1,602,034 | \$ 601,359 |
| Noncurrent assets | 86,939 | 136,757 | 202,324 |
| Total Assets | 2,026,308 | 1,738,791 | 803,683 |
| LIABILITIES | | | |
| Current liabilities | 1,939,369 | 1,602,034 | 601,359 |
| Total Liabilities | 1,939,369 | 1,602,034 | 601,359 |
| NET POSITION | | | |
| Net investment in capital assets | \$ 86,939 | \$ 136,757 | \$ 202,324 |

Assets. As of June 30, 2016, CKMS's total assets amounted to \$2,026,308. Cash and cash equivalents, totaling \$1,493,096 or 73.7% of total assets, represented CKMS's largest asset. Due from the University of Kentucky was CKMS's second largest asset totaling \$428,245 or 21.1% of total assets, representing reimbursements owed for staffing services due to timing of payroll dates. Capital assets, net, represented CKMS's third largest asset, totaling \$86,939 or 4.3% of total assets.

Total assets increased \$287,517 during the year ended June 30, 2016, driven primarily by an increase in cash and cash equivalents of \$943,690 offset by decreases in due from the University of Kentucky of \$606,692 and capital assets, net, of \$49,818.

Liabilities. At June 30, 2016, CKMS's liabilities increased 21.1% to a total of \$1,939,369. Accounts payable and accrued liabilities, consisting of accrued wages, expenses and payroll withholdings, was CKMS's largest liability totaling \$1,855,950 or 95.7%. The remaining liabilities, totaling \$83,419 or 4.3%, were for an escrow account payable to the UK HealthCare Hospital System, representing net operating revenue in excess of expenses.

Net Position. Net position at June 30, 2016 totaled \$86,939 or 4.3% of total assets, all of which were net investment in capital assets.

2015 versus 2014. Total assets increased \$935,108 during the year ended June 30, 2015, primarily driven by an increase in due from the University of Kentucky of \$1,034,937 offset by decreases of \$65,567 in capital assets, net of depreciation, and \$37,988 in cash and cash equivalents. Total liabilities increased \$1,000,675, or 166.4%, due to an increase of \$1,201,207 in accounts payable and accrued liabilities offset by a decrease of \$200,532 in the escrow payable to the UK HealthCare Hospital System. Total net position decreased \$65,567, or 32.4%, in 2015 from 2014.

Statements of Revenues, Expenses and Changes in Net Position

| | 2016 | 2015 | 2014 |
|---|-------------------|-------------------|-------------------|
| OPERATING REVENUES | | | |
| Collections | \$ 619,302,076 | \$ 576,311,005 | \$ 478,338,945 |
| Remittance to the University of Kentucky and its affiliated corporations | (611,851,024) | (569,200,129) | (471,633,529) |
| Healthcare staffing services | 23,548,363 | 19,202,158 | - |
| Other revenue | 405,313 | 394,991 | 412,241 |
| Total operating revenues | <u>31,404,728</u> | <u>26,708,025</u> | <u>7,117,657</u> |
| OPERATING EXPENSES | | | |
| Salaries and wages | 22,738,391 | 18,906,902 | 3,964,427 |
| Employee benefits | 6,565,175 | 5,834,456 | 1,431,308 |
| Legal and professional | 1,065,213 | 876,541 | 571,021 |
| Communications | 413,507 | 376,214 | 381,433 |
| Depreciation | 27,388 | 43,141 | 62,258 |
| Other | 616,868 | 701,362 | 665,882 |
| Total operating expenses | <u>31,426,542</u> | <u>26,738,616</u> | <u>7,076,329</u> |
| OPERATING INCOME (LOSS) | <u>(21,814)</u> | <u>(30,591)</u> | <u>41,328</u> |
| NONOPERATING REVENUES | | | |
| Investment income | 116 | 964 | 428 |
| (Loss) on disposal of fixed assets | (28,120) | (35,940) | - |
| Total nonoperating revenues | <u>(28,004)</u> | <u>(34,976)</u> | <u>428</u> |
| Total increase (decrease) in net position | (49,818) | (65,567) | 41,756 |
| Net position, beginning of year | <u>136,757</u> | <u>202,324</u> | <u>160,568</u> |
| Net position, end of year | <u>\$ 86,939</u> | <u>\$ 136,757</u> | <u>\$ 202,324</u> |

2016. Operating revenues increased \$4,696,703 or 17.6% to \$31,404,728 for the year ended June 30, 2016. The sources of operating revenue for CKMS are collections for health care receivables for the University and its affiliated corporations and reimbursements for staffing services provided for the UK HealthCare Hospital System. The increase was primarily due to revenue from providing staffing services for the UK HealthCare Hospital System.

Operating expenses, including \$27,388 of depreciation, totaled \$31,426,542. Of this amount, \$22,738,391 or 72.4% was used for salaries and wages. Operating expenses increased \$4,687,926 or 17.5% from the prior year. The increase was primarily due to increases in salaries, wages, and employee benefits caused by providing staffing and other support to the UK HealthCare Hospital System. Legal and professional expenses increased as well.

2015 versus 2014. During the year ended June 30, 2015, operating revenues increased \$19,590,368 or 275.2% primarily due to revenue from providing staffing services for the UK HealthCare Hospital System beginning in 2015. Operating expenses increased \$19,662,287 or 277.9% due primarily to increases in salaries, wages, and employee benefits caused by providing staffing and other support to the UK HealthCare Hospital System.

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

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

Statements of Cash Flows

| | 2016 | 2015 | 2014 |
|--|---------------------|-------------------|-------------------|
| CASH PROVIDED (USED) BY: | | | |
| Operating activities | \$ 949,264 | \$ (25,438) | \$ 193,242 |
| Capital financing activities | (5,690) | (13,514) | (104,014) |
| Investing activities | 116 | 964 | 428 |
| Net increase (decrease) in cash and cash equivalents | 943,690 | (37,988) | 89,656 |
| Cash and cash equivalents, beginning of year | <u>549,406</u> | <u>587,394</u> | <u>497,738</u> |
| Cash and cash equivalents, end of year | <u>\$ 1,493,096</u> | <u>\$ 549,406</u> | <u>\$ 587,394</u> |

2016. Cash receipts of \$7,447,318 relate to collections, net of remittances to the University and its affiliated corporations, and \$24,155,055 relates to the reimbursements for staffing services provided for the UK HealthCare Hospital System. Cash payments for operating activities were primarily made to employees for salaries, wages and benefits of \$28,959,079. Cash used by capital financing activities is expended on the acquisition of capital assets.

2015 versus 2014. The net decrease in cash was \$37,988 due primarily to cash used by operating activities and capital financing activities.

Capital Asset and Debt Administration

Capital Assets. Capital assets, net of accumulated depreciation, totaled \$86,939 at June 30, 2016, a net decrease of \$49,818 from 2015. Capital assets represent purchases of equipment. There was \$5,690 expended on additions to equipment during fiscal year 2015-16, and depreciation expense was \$27,388. Equipment with a net value of \$28,120 was disposed of in fiscal year 2015-16.

Debt. CKMS does not have any debt outstanding as of June 30, 2016.

Factors Impacting Future Periods

The quantity and quality of health care receivables of the University and its related corporations could affect future financial results. Changes to the Affordable Care Act or other healthcare reforms would impact the U.S. healthcare system. CKMS cannot predict the potential impact these reforms may have on future financial results.

CENTRAL KENTUCKY MANAGEMENT SERVICES, INC.
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF NET POSITION
JUNE 30, 2016 AND 2015

| | <u>2016</u> | <u>2015</u> |
|---|------------------|-------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 1,493,096 | \$ 549,406 |
| Due from University of Kentucky | 428,245 | 1,034,937 |
| Other current assets | 18,028 | 17,691 |
| Total current assets | <u>1,939,369</u> | <u>1,602,034</u> |
| Noncurrent Assets | | |
| Capital assets, net | 86,939 | 136,757 |
| Total noncurrent assets | <u>86,939</u> | <u>136,757</u> |
| Total assets | <u>2,026,308</u> | <u>1,738,791</u> |
| LIABILITIES | | |
| Current Liabilities | | |
| Escrow account - University of Kentucky and its affiliated corporations | 83,419 | 87,153 |
| Accounts payable and accrued liabilities | 1,855,950 | 1,514,881 |
| Total current liabilities | <u>1,939,369</u> | <u>1,602,034</u> |
| Total liabilities | <u>1,939,369</u> | <u>1,602,034</u> |
| NET POSITION | | |
| Net investment in capital assets | <u>\$ 86,939</u> | <u>\$ 136,757</u> |

See notes to financial statements

CENTRAL KENTUCKY MANAGEMENT SERVICES, INC.
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

| | <u>2016</u> | <u>2015</u> |
|---|-------------------|-------------------|
| OPERATING REVENUES | | |
| Collections | \$ 619,302,076 | \$ 576,311,005 |
| Less: Remittance to the University of Kentucky and its affiliated corporations | (611,851,024) | (569,200,129) |
| Healthcare staffing services | 23,548,363 | 19,202,158 |
| Other revenues | 405,313 | 394,991 |
| Total operating revenues | <u>31,404,728</u> | <u>26,708,025</u> |
| OPERATING EXPENSES | | |
| Salaries and wages | 22,738,391 | 18,906,902 |
| Employee benefits | 6,565,175 | 5,834,456 |
| Legal and professional | 1,065,213 | 876,541 |
| Communications | 413,507 | 376,214 |
| Depreciation | 27,388 | 43,141 |
| Other expenses | 616,868 | 701,362 |
| Total operating expenses | <u>31,426,542</u> | <u>26,738,616</u> |
| Operating income (loss) | <u>(21,814)</u> | <u>(30,591)</u> |
| NONOPERATING REVENUES (EXPENSES) | | |
| Investment income | 116 | 964 |
| (Loss) on disposal of fixed assets | (28,120) | (35,940) |
| Total nonoperating revenues (expenses) | <u>(28,004)</u> | <u>(34,976)</u> |
| Increase (decrease) in net position | <u>(49,818)</u> | <u>(65,567)</u> |
| NET POSITION, beginning of year | <u>136,757</u> | <u>202,324</u> |
| NET POSITION, end of year | <u>\$ 86,939</u> | <u>\$ 136,757</u> |

See notes to financial statements

CENTRAL KENTUCKY MANAGEMENT SERVICES, INC.
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

| | <u>2016</u> | <u>2015</u> |
|---|----------------------------|---------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Collections | \$ 619,302,076 | \$ 576,311,005 |
| Remittances to University of Kentucky and its affiliated corporations | (611,854,758) | (569,400,661) |
| Healthcare staffing services | 24,155,055 | 18,167,221 |
| Payments to vendors and contractors | (1,482,475) | (1,347,261) |
| Salaries, wages and benefits | (28,959,079) | (23,449,371) |
| Other receipts (payments) | <u>(211,555)</u> | <u>(306,371)</u> |
| Net cash provided (used) by operating activities | <u>949,264</u> | <u>(25,438)</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Purchases of capital assets | <u>(5,690)</u> | <u>(13,514)</u> |
| Net cash (used) by capital and related financing activities | <u>(5,690)</u> | <u>(13,514)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Interest on cash and cash equivalents | <u>116</u> | <u>964</u> |
| Net cash provided (used) by investing activities | <u>116</u> | <u>964</u> |
| NET INCREASE (DECREASE) IN CASH | <u>943,690</u> | <u>(37,988)</u> |
| CASH AND CASH EQUIVALENTS, beginning of year | <u>549,406</u> | <u>587,394</u> |
| CASH AND CASH EQUIVALENTS, end of year | <u><u>\$ 1,493,096</u></u> | <u><u>\$ 549,406</u></u> |
| Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities: | | |
| Operating income (loss) | \$ (21,814) | \$ (30,591) |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: | | |
| Depreciation expense | 27,388 | 43,141 |
| Change in assets and liabilities: | | |
| Due from University of Kentucky | 606,692 | (1,034,937) |
| Other current assets | (337) | (3,726) |
| Escrow account | (3,734) | (200,532) |
| Accounts payable and accrued liabilities | <u>341,069</u> | <u>1,201,207</u> |
| Net cash provided (used) by operating activities | <u><u>\$ 949,264</u></u> | <u><u>\$ (25,438)</u></u> |

See notes to financial statements

CENTRAL KENTUCKY MANAGEMENT SERVICES, INC.
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Central Kentucky Management Services, Inc. (CKMS) provides collection services for the health care receivables of the University of Kentucky (the University) and its related corporations. All commission revenues are received from these entities and the excess of revenues over expenses is distributed back to these entities. CKMS also provides staffing services to health care facilities for the University on a direct cost reimbursement basis. CKMS is considered to be an affiliate and component unit of the University because the Board of Directors is appointed by the President of the University and officers of CKMS are also officers of the University.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net position categories:

- Net investment in capital assets: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
 - Nonexpendable* – Net position subject to externally imposed stipulations that they be maintained permanently by CKMS.
 - Expendable* – Net position whose use by CKMS is subject to externally imposed stipulations that can be fulfilled by actions of CKMS pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net position whose use by CKMS is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation required by GASB Statement No. 35 is intended to provide a comprehensive, entity-wide perspective of CKMS'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. CKMS reports as a Business Type Activity (BTA) as defined by GASB 35. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

Cash and Cash Equivalents. Cash and cash equivalents include investments with a maturity of three months or less.

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 \$5,000 or more and having an estimated useful life of greater than one year is 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 3 – 20 years for equipment.

Operating Activities. CKMS 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 services and goods received. Nearly all of CKMS’s revenues and expenses are from exchange transactions.

Income Taxes. CKMS is exempt from federal income tax under the Internal Revenue Code as a section 501(c)(3) organization.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to use estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The accompanying financial statements include estimates for items such as depreciable lives on capital assets and accrued liability accounts.

Reclassifications. Certain reclassifications have been made to the fiscal year 2015 financial statements to conform to the fiscal year 2016 financial statement presentation. These reclassifications had no effect on change in net position.

2. DEPOSITS AND INVESTMENTS

The fair value and cost of deposits and investments, by type, at June 30, 2016 and 2015 are as follows:

| | <u>2016</u> | <u>2015</u> |
|-------------------------------------|---------------------|-------------------|
| Cash on deposit with the University | <u>\$ 1,493,096</u> | <u>\$ 549,406</u> |

Deposit and Investment Policies. CKMS 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 CKMS’s funds.

For purposes of investment management, CKMS’s deposits and investments can be grouped into one significant category, as follows: cash on deposit with the University, which the University invests in deposits with banks and the Commonwealth of Kentucky (the Commonwealth). During the fiscal year ended June 30, 2015, the University also invested in repurchase agreements with banks and the Commonwealth.

Cash on deposit with the University is managed based on the University’s Overnight Fund Investment Policy.

Deposit and Investment Risks. CKMS’s deposits and investments are exposed to various risks as discussed in more detail below.

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing CKMS to experience a loss of principal. Cash on deposit with the University is governed by policy that minimizes risk in several ways. Deposits are governed by state law which requires full collateralization for balances exceeding amounts covered by the Federal Deposit Insurance Corporation (FDIC). CKMS’s deposits are insured up to \$250,000 at each FDIC insured institution. Credit risk on repurchase agreements is mitigated by requiring the issuing financial institution’s pledge of specific U.S. Treasury or agency securities, held in the name of the University by the Federal Reserve Bank.

Credit risk on repurchase agreements with the Commonwealth is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. Treasury or agency securities, pledged in the name of the Commonwealth.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, CKMS will not be able to recover the value of its investment or collateral securities that are in possession of an outside party. Cash on deposit with the University is invested in deposits and repurchase agreements held in the University's name, and in deposits and repurchase agreements with the Commonwealth that are held in the Commonwealth's name. The University maintains records evidencing CKMS's ownership interest in such balances.

Concentrations of Credit Risk. CKMS's investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer. Cash on deposit with the University is not limited as to the maximum amount that may be deposited or invested in one issuer. However, all such deposits in excess of federal deposit insurance are required to be fully collateralized by U.S. Treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.

At June 30, 2016, CKMS had no underlying investments in any one issuer that represents more than five percent of total investments.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Cash on deposit with the University has limited exposure to interest rate risk due to the short term nature of the investment. The University requires that all deposits and overnight repurchase agreements be available for use on the next business day.

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. CKMS is not exposed to foreign currency risk.

3. CAPITAL ASSETS, NET

Capital assets as of June 30, 2016 and 2015 are summarized as follows:

| | 2016 | | | |
|--------------------------|-------------------|--------------------|------------------|------------------|
| | Beginning Balance | Additions | Deletions | Ending Balance |
| Equipment | \$ 1,222,150 | \$ 5,690 | \$ 497,691 | \$ 730,149 |
| Accumulated depreciation | 1,085,393 | 27,388 | 469,571 | 643,210 |
| Capital assets, net | <u>\$ 136,757</u> | <u>\$ (21,698)</u> | <u>\$ 28,120</u> | <u>\$ 86,939</u> |

| | 2015 | | | |
|--------------------------|-------------------|--------------------|------------------|-------------------|
| | Beginning Balance | Additions | Deletions | Ending Balance |
| Equipment | \$ 1,331,860 | \$ 13,514 | \$ 123,224 | \$ 1,222,150 |
| Accumulated depreciation | 1,129,536 | 43,141 | 87,284 | 1,085,393 |
| Capital assets, net | <u>\$ 202,324</u> | <u>\$ (29,627)</u> | <u>\$ 35,940</u> | <u>\$ 136,757</u> |

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2016 and 2015 are as follows:

| | 2016 | 2015 |
|---|---------------------|---------------------|
| Accounts payable | \$ 21,969 | \$ 25,387 |
| Accrued wages, expenses and payroll taxes | 1,833,981 | 1,489,494 |
| Total | <u>\$ 1,855,950</u> | <u>\$ 1,514,881</u> |

5. PENSION PLAN

Eligible staff members of CKMS are participants in the University of Kentucky Retirement Plan. Under this plan, CKMS and plan participants make contributions to provide retirement benefits for employees. All payments were vested immediately for employees hired before January 1, 2010. For employees hired after that date, employee contributions are vested after three years, which was an amendment to the vesting rule adopted in 2013. CKMS contributes 10% of eligible compensation and employees contribute five percent of eligible compensation. CKMS's share of the costs of these benefits was \$1,630,802 and \$1,417,864 in 2016 and 2015, respectively.

6. LEASES

Office space is provided to CKMS by the UK HealthCare Hospital System at no charge. The fair rental value of the office space including utilities was \$335,183 and \$338,310 for 2016 and 2015, respectively, and is recorded in other revenues and other expenses.

7. RISK MANAGEMENT

CKMS is exposed to various risks of loss related to torts; theft of, damages to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by commercial insurance, extension of coverage by the University's participation in an insurance risk retention group or by self-insurance. There have been no significant reductions in insurance coverage from 2015 to 2016. Settlements have not exceeded insurance coverage during the past three years.

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 also self-insures certain employee benefits, unemployment claims, and a long-term disability supplemental reserve, to the extent not covered by insurance. CKMS employees are covered under both of these University plans.

8. HEALTH INSURANCE BENEFITS FOR RETIREES

The University administers a single-employer defined benefit healthcare plan including medical and prescription drug benefits. CKMS may participate in this plan, which 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 \$25 per month or 10% of total plan cost.

The University has established a trust fund to segregate plan assets, and currently plans to contribute amounts to the trust fund sufficient to fully fund the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45.

CKMS has recognized its share of the contribution in employee benefit costs and has no additional liability for this benefit at June 30, 2016.

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