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UNIVERSITY OF  
**KENTUCKY**<sup>®</sup>  
 2013 Financial Statements  
*Gluck Equine Research  
 Foundation, Inc.*

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**University of Kentucky**  
**Gluck Equine Research Foundation, Inc.**  
**A Component Unit of the University of Kentucky**

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## Independent Auditor's Report

Board of Directors  
University of Kentucky  
Gluck Equine Research Foundation, Inc.  
Lexington, Kentucky

We have audited the accompanying basic financial statements, which are comprised of the statements of net position as of June 30, 2013 and 2012, and statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the financial statements, as listed in the table of contents, of the University of Kentucky Gluck Equine Research Foundation, Inc. (Foundation), 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 Foundation'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 Foundation's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## **Opinion**

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

## **Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis 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 1, 2013

# Management's Discussion and Analysis

The University of Kentucky Gluck Equine Research Foundation's (the Foundation) Management's Discussion and Analysis (MD&A) of its financial condition provides an overview of the financial performance of the Foundation for the years ended June 30, 2013 and 2012. Management has prepared this discussion, which provides summary financial information, along with the financial statements and related footnotes. MD&A should be read in conjunction with the accompanying financial statements.

## Financial Highlights

- Total assets increased \$536,151 or 7.1%. The most significant components of the increase were the \$429,197 increase in market value of endowment investments and \$120,111 increase in cash and cash equivalents.
- Total net position increased \$535,902 or 7.1%, primarily due to an increase in the market value of investments.
- Net position represented nearly 100% of total assets.

## Using the Annual Report

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

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

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

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

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

## Reporting Entity

The University of Kentucky Gluck Equine Research Foundation, Inc. is a not-for-profit Kentucky corporation formed to establish a continuing partnership between the University of Kentucky and the equine industry of the Commonwealth of Kentucky. The Foundation's objective is to enhance and improve the equine research program at the University of Kentucky (the University) so that it will be one of the finest in the world. The Foundation is considered to be an affiliate and component unit of the University because all Board members are related to the University as faculty, staff or trustees and/or are appointed by the President of the University, and certain officers of the Foundation are officers of the University.

## Condensed Financial Information

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>ASSETS</b>			
Current Assets	\$ 143,089	\$ 22,409	\$ 14,422
Noncurrent assets	7,934,360	7,518,889	8,010,140
Total assets	<u>8,077,449</u>	<u>7,541,298</u>	<u>8,024,562</u>
<b>LIABILITIES</b>			
Current liabilities	249	-	-
Total liabilities	<u>249</u>	<u>-</u>	<u>-</u>
<b>NET POSITION</b>			
Restricted			
Nonexpendable	4,607,271	4,607,271	4,607,071
Expendable	3,469,929	2,934,027	3,417,491
Total net position	<u>\$ 8,077,200</u>	<u>\$ 7,541,298</u>	<u>\$ 8,024,562</u>

## Statements of Net Position

**Assets.** As of June 30, 2013 the Foundation's assets totaled \$8,077,449. Endowment investments represented 98.2% of the Foundation's assets, totaling \$7,934,360.

Total assets increased \$536,151 during the year ended June 30, 2013. Endowment investments increased \$429,197 primarily due to an increase in the market value of investments due to improved market conditions. Cash and cash equivalents increased \$120,111 primarily due to a decrease in grants to the University of Kentucky for capital purposes. Pledges receivable decreased \$13,157.

**Net Position.** Net position at June 30, 2013 totaled \$8,077,200, or nearly 100% of total assets, all of which were restricted net position. Total expendable net position increased \$535,902 during the year ended June 30, 2013, primarily due to the gain on investments mentioned above.

**2012 Versus 2011.** Total assets decreased \$483,264 when comparing fiscal 2012 with fiscal 2011 primarily due to a decrease in endowment investments of \$477,777 and a decrease in pledges receivable. Total expendable net position decreased \$483,464 during the year ended June 30, 2012, primarily due to grants to the University exceeding revenues and a loss on investments.

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>OPERATING REVENUES</b>			
Operating revenue	<u>\$ 949,207</u>	<u>\$ 37,326</u>	<u>\$ 1,365,856</u>
Total operating revenues	<u>949,207</u>	<u>37,326</u>	<u>1,365,856</u>
<b>OPERATING EXPENSES</b>			
Education and general	19,213	4,729	30,307
Grants to the University of Kentucky - non-capital	380,334	364,315	735,833
Grants to the University of Kentucky - capital	<u>13,758</u>	<u>151,746</u>	<u>-</u>
Total operating expenses	<u>413,305</u>	<u>520,790</u>	<u>766,140</u>
<b>NET INCOME (LOSS) FROM OPERATIONS</b>	<u>535,902</u>	<u>(483,464)</u>	<u>599,716</u>
<b>NONOPERATING REVENUES</b>			
Additions to permanent endowments	<u>-</u>	<u>200</u>	<u>-</u>
Total nonoperating revenues	<u>-</u>	<u>200</u>	<u>-</u>
Total increase (decrease) in net position	535,902	(483,264)	599,716
<b>Net position, beginning of year</b>	<u>7,541,298</u>	<u>8,024,562</u>	<u>7,424,846</u>
<b>Net position, end of year</b>	<u><u>\$ 8,077,200</u></u>	<u><u>\$ 7,541,298</u></u>	<u><u>\$ 8,024,562</u></u>

**2013.** Operating revenues included gifts of \$96,217 and a gain on investments of \$852,240. Operating revenues increased \$911,881 from the previous year because of a gain on endowment investments due to improved market conditions.

Operating expenses totaled \$413,305, decreasing \$107,485 due to a decrease in grants to the University for capital purposes of \$137,988 offset by an increase in grants to the University for non-capital purposes of \$16,019 and an increase in education and general expense of \$14,484.

**2012 Versus 2011.** Operating revenues decreased \$1,328,530 when comparing fiscal year 2012 to fiscal year 2011. This decrease was due to a loss on endowment investments due to a decline in market conditions in 2012 offset by a small increase in gift revenue. Operating expenses decreased \$245,350 due to a decrease in grants to the University for non-capital purposes of \$371,518 and a decrease in education and general expense of \$25,578 offset by an increase in grants to the University for capital purposes of \$151,746.

### **Statements of Cash Flows**

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

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<b>CASH PROVIDED (USED) BY:</b>			
Operating activities	\$ (302,932)	\$ (411,871)	\$ (659,912)
Noncapital financing activities	-	200	-
Investing activities	<u>423,043</u>	<u>419,943</u>	<u>359,859</u>
Net increase (decrease) in cash and cash equivalents	120,111	8,272	(300,053)
<b>Cash and cash equivalents, beginning of year</b>	<u>8,272</u>	<u>-</u>	<u>300,053</u>
<b>Cash and cash equivalents, end of year</b>	<u><u>\$ 128,383</u></u>	<u><u>\$ 8,272</u></u>	<u><u>\$ -</u></u>

**2013.** The largest cash receipt from operating activities related to private gifts of \$109,374 while the most significant use of cash was for grants to the University for non-capital purposes of \$380,334.

Cash provided by investing activities included \$5,209,129 from the sale of investments, net of \$4,919,419 used in the purchase of investments, and \$133,333 from interest and dividends.

**2012 Versus 2011.** Cash flows fluctuated in the area of operating activities when comparing fiscal year 2012 to fiscal year 2011 primarily due to a decrease in grants to the University for capital purposes offset by an increase in grants to the University for non capital purposes.

### **Capital Asset and Debt Administration**

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

**Debt.** The Foundation had no debt at or during the year ended June 30, 2013.

### **Factors Impacting Future Periods**

Due to the current economic climate, investment losses and declines in donations could negatively impact the Foundation's future financial results.



**UNIVERSITY OF KENTUCKY GLUCK EQUINE RESEARCH FOUNDATION, INC.**  
**A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY**  
**STATEMENTS OF NET POSITION**  
**JUNE 30, 2013 AND 2012**

	<u>2013</u>	<u>2012</u>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 128,383	\$ 8,272
Pledges receivable, net	14,706	14,137
Total current assets	<u>143,089</u>	<u>22,409</u>
<b>Noncurrent Assets</b>		
Endowment investments	7,934,360	7,505,163
Pledges receivable, net	-	13,726
Total noncurrent assets	<u>7,934,360</u>	<u>7,518,889</u>
Total assets	<u>8,077,449</u>	<u>7,541,298</u>
 <b>LIABILITIES</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	249	-
Total current liabilities	<u>249</u>	<u>-</u>
Total liabilities	<u>249</u>	<u>-</u>
 <b>NET POSITION</b>		
<b>Restricted</b>		
Nonexpendable	4,607,271	4,607,271
Expendable	3,469,929	2,934,027
Total restricted	<u>8,077,200</u>	<u>7,541,298</u>
Total net position	<u>\$ 8,077,200</u>	<u>\$ 7,541,298</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY GLUCK EQUINE RESEARCH FOUNDATION, INC.  
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY  
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION  
JUNE 30, 2013 AND 2012**

	<u>2013</u>	<u>2012</u>
<b>OPERATING REVENUES</b>		
Gifts	\$ 96,217	\$ 95,160
Investment income (loss)	852,240	(57,834)
Sales related to fundraising activities	750	-
Total operating revenues	<u>949,207</u>	<u>37,326</u>
<b>OPERATING EXPENSES</b>		
Educational and general:		
Research	8,661	4,429
Institutional support	10,552	300
Total educational and general	<u>19,213</u>	<u>4,729</u>
Grants to (from) the University of Kentucky for non-capital purposes	380,334	364,315
Grants to (from) the University of Kentucky for capital purposes	13,758	151,746
Total operating expenses	<u>413,305</u>	<u>520,790</u>
Net income (loss) from operations	<u>535,902</u>	<u>(483,464)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Additions to permanent endowments	-	200
Total other revenues (expenses)	<u>-</u>	<u>200</u>
Increase (decrease) in net position	<u>535,902</u>	<u>(483,264)</u>
<b>NET POSITION, beginning of year</b>	<u>7,541,298</u>	<u>8,024,562</u>
<b>NET POSITION, end of year</b>	<u>\$ 8,077,200</u>	<u>\$ 7,541,298</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY GLUCK EQUINE RESEARCH FOUNDATION, INC.**  
**A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY**  
**STATEMENTS OF CASH FLOWS**  
**JUNE 30, 2013 AND 2012**

	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Private gifts	\$ 109,374	\$ 108,919
Payments to vendors and contractors	(11,002)	(2,868)
Salaries, wages and benefits reimbursements to the University of Kentucky	(7,962)	(1,861)
Grants (to) from the University of Kentucky for non-capital purposes	(380,334)	(364,315)
Grants (to) from the University of Kentucky for capital purposes	(13,758)	(151,746)
Other receipts (payments)	750	-
Net cash provided (used) by operating activities	<u>(302,932)</u>	<u>(411,871)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Private gifts for endowment purposes	-	200
Net cash provided (used) by noncapital financing activities	<u>-</u>	<u>200</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales and maturities of investments	5,209,129	3,479,135
Interest and dividends on investments	133,333	123,630
Purchase of investments	<u>(4,919,419)</u>	<u>(3,182,822)</u>
Net cash provided (used) by investing activities	<u>423,043</u>	<u>419,943</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	120,111	8,272
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>8,272</u>	<u>-</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 128,383</u>	<u>\$ 8,272</u>
<b>Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:</b>		
Net income (loss) from operations	\$ 535,902	\$ (483,464)
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Investment (income) loss	(852,240)	57,834
Change in assets and liabilities:		
Pledges receivable, net	13,157	13,759
Accounts payable and accrued liabilities	249	-
<b>Net cash provided (used) by operating activities</b>	<u>\$ (302,932)</u>	<u>\$ (411,871)</u>

See notes to financial statements.

# NOTES TO FINANCIAL STATEMENTS

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Reporting Entity

The University of Kentucky Gluck Equine Research Foundation, Inc. (the Foundation) is a not-for-profit Kentucky corporation formed to establish a continuing partnership between the University of Kentucky (the University) and the equine industry of the Commonwealth of Kentucky (the Commonwealth). The Foundation's objective is to enhance and improve the equine research program at the University so that it will be one of the finest in the world. The Foundation is considered to be an affiliate and component unit of the University because all Board members are related to the University as faculty, staff or trustees and/or are appointed by the President of the University, and certain officers of the Foundation are officers of the University.

### Basis of Presentation

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

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

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the Foundation's assets, deferred outflows of resources, liabilities, deferred inflows of resources, net position, revenues, expenses, changes in net position and cash flows.

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

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

In addition to assets, GASB No. 63 requires the presentation of a separate financial statement element, deferred outflows of resources, which represents a consumption of net position that applies to a future period. The Foundation has no items that qualify for reporting in this category.

In addition to liabilities, GASB No. 63 requires the presentation of a separate financial statement element, deferred inflows of resources, which represents an acquisition of net position that applies to a future period. The Foundation has no items that qualify for reporting in this category.

### **Summary of Significant Accounting Policies**

Accrual Basis. The financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred.

Cash and Cash Equivalents. The Foundation considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Cash and cash equivalents of the Foundation's endowment fund are included in noncurrent endowment investments.

Pooled Endowment Funds. All endowments are managed in a consolidated investment pool, which consists of more than 2,000 named funds. All contributing endowments participate in the income and appreciation of the pool on a per unit basis commensurate with their contribution to the pool. New endowments purchase units in the pool at the current unit value, which is calculated each month based on the fair value of the pool investments divided by the number of pool units outstanding. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

In accordance with the Kentucky Uniform Prudent Management of Institutional Funds Act (UPMIFA), as adopted by the Commonwealth in July 2010, the University employs a total return method for establishing investment objectives and spending policies designed to achieve financial equilibrium for endowment funds over the long term. The University has made expenditure decisions in accordance with UPMIFA and donor gift agreements. UPMIFA prescribes guidelines for expenditure of a donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations) and focuses on the entirety of a donor-restricted endowment fund, that is, both the original gift amount(s) and net appreciation. In accordance with the standard of prudence prescribed by UPMIFA and consistent with industry standards, the University has adopted a spending policy whose long-term objective is to maintain the purchasing power of each endowment and provide a predictable and sustainable level of income to support current operations.

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

The amount of gross spending policy distribution in accordance with the University's endowment spending policy was \$303,491 and \$314,381 for the years ended June 30, 2013 and 2012, respectively.

For future years the University has established a "hybrid" spending policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending will be calculated by taking a weighted average comprising 60% of the prior year's spending, adjusted for inflation, and 40% of the amount that results when the target annual spending rate of four percent is applied to the average market value of the Endowment over the preceding 36 months. The spending amount determined by the formula will be constrained so that the calculated rate is at least three percent, and not more than six percent, of the current Endowment market value. The hybrid spending policy will be phased in over two years. The year ended June 20, 2014 will serve as a transition year to

the new policy and spending will be based on four percent of the average market value for the preceding 60 months. The hybrid policy will be fully implemented in the year ended June 30, 2015.

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

Investments. Investments in marketable securities are carried at fair value, as determined by the major securities markets. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income in the Statement of Revenues, Expenses and Changes in Net Position.

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

Restricted Asset Spending Policy. The Foundation's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination of whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

Operating Activities. The Foundation defines operating activities, as reported on the Statement of Revenues, Expenses and Changes in Net Position, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for goods and services received. Gifts and endowment and investment income are also classified as operating revenues because fundraising activities represent the Foundation's primary operating purpose.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to use estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

## 2. DEPOSITS AND INVESTMENTS

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

	2013	2012
Cash on deposit with the University	\$ 128,383	\$ 8,272
Investment in University pooled endowment fund	7,934,360	7,505,163
Total	\$ 8,062,743	\$ 7,513,435

At June 30, 2013, the University's pooled endowment fund consisted of common and preferred stock (4.3%), pooled equity funds (37.9%), pooled private equity funds (8.3%), pooled absolute return funds (20.2%), pooled real return funds (8.5%), pooled real estate funds (6.7%), U.S. Treasury fixed income (0.8%), government agency fixed income funds (0.9%), corporate fixed income funds (2.3%), pooled fixed income funds (9.3%) and cash and cash equivalents (0.8%). At June 30, 2012, the University's pooled endowment fund consisted of common and preferred stock (3.6%), pooled equity funds (37.5%), pooled private equity funds (7.5%), pooled absolute return funds (19.7%), pooled real return funds (9.5%), pooled real estate funds (6.6%), U.S. Treasury fixed income (1.0%), government agency fixed income funds (1.0%), corporate fixed income funds (2.9%), pooled fixed income funds (10.5%) and cash and cash equivalents (0.2%).

**Deposit and investment policies.** The Foundation 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 Foundation's funds.

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

- Cash on deposit with the University, which the University invests in deposits and repurchase agreements with banks and the Commonwealth, and
- Endowment investments in the University's pooled endowment fund.

Cash on deposit with the University is managed based on the University's Operating Fund Investment Policy.

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

**Deposit and investment policies.** The Foundation's deposits and investments are exposed to various risks, including credit, interest rate and foreign currency risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could affect the investment amounts in the 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 Foundation to experience a loss of principal. As a means of limiting its exposure to losses arising from credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Cash 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. The Foundation'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.
- Endowment managers are permitted to use derivative instruments to limit credit risk. Additionally, endowment investments held by the University's fixed income managers are generally limited to holdings of high quality fixed income securities. These managers may invest a portion of the portfolio in other below-investment grade bonds, non-U.S. dollar denominated bonds, and emerging market bonds, provided the overall credit quality of the fixed income portfolios is not lower than A-.

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

- Endowment investments are held in the University's name by the University's custodian. The University maintains records of the Foundation's ownership interest (units) in the University's pooled endowment fund.

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

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

- Cash on deposit with the University is not limited as to the maximum amount that may be invested in one issuer. However, all such deposits in excess of Federal Depository Insurance are required to be fully collateralized by U.S. Treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- 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, 2013, the Foundation had no underlying investments in any one issuer which represent more than five percent of total investments, other than U.S. Treasury and agency obligations.

**Interest Rate Risk.** Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Cash 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.
- Endowment managers are permitted to use derivative instruments to limit interest rate risk. Additionally, endowment investments held by the University's fixed income managers are limited to a duration that is within +/-25% of the duration of the Barclays Aggregate Bond Index.

**Foreign Currency Risk.** Foreign currency risk is the risk that fluctuations in exchange rates will adversely affect the fair value of an investment or deposit.

The Foundation's exposure to foreign currency risk derives from certain endowment investments 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. The University's investments in the various pooled funds are denominated in U.S. dollars, with the exception of two private equity funds denominated in Euros. Endowment managers are permitted to use derivative instruments to limit foreign currency risk.



### 3. PLEDGES RECEIVABLE

In accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the Foundation is required to record pledges as revenue when all eligibility requirements have been met. For the years ended June 30, 2013 and 2012, the Foundation recorded the discounted value of pledges receivable using a rate of two and three percent, respectively.

At June 30, 2013, pledges are expected to be collected over the next year, as follows:

	<u>2013</u>	<u>2012</u>
Capital Pledges	\$ 20,000	\$ 40,000
Less discounts and allowances	<u>(5,294)</u>	<u>(12,137)</u>
Total	<u>\$ 14,706</u>	<u>\$ 27,863</u>

### 4. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Interest and dividends earned on endowment investments	\$ 133,060	\$ 123,420
Realized and unrealized gains and losses on endowment investments	718,907	(181,464)
Interest on cash and non-endowment investments	<u>273</u>	<u>210</u>
Total	<u>\$ 852,240</u>	<u>\$ (57,834)</u>

### 5. RISK MANAGEMENT

The Foundation is exposed to various risks of loss related to torts and errors and omissions. These risks are covered by extension of coverage by the University's participation in an insurance risk retention group and self-insurance. Claims against directors and officers for wrongful acts (errors and omissions) are insured through a risk retention group. There have been no significant reductions in insurance coverage from 2012 to 2013. Settlements have not exceeded insurance coverage during the past three years.

### 6. TRANSACTIONS WITH THE UNIVERSITY

Grants to the University are for the purposes of equine research, support of the Gluck Equine Research Center and for the endowment management fees. All salaries, wages and benefits reimbursements to the University represent charges for University employees.

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