



Financial Statements

for

**KENTUCKY MEDICAL
SERVICES FOUNDATION, INC.**

*Years Ended June 30, 2022 and 2021
with Report of Independent Auditors*

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Report of Independent Auditors

To the Board of Directors of
Kentucky Medical Services Foundation, Inc.
Lexington, Kentucky

Opinion

We have audited the financial statements of Kentucky Medical Services Foundation, Inc. (KMSF), which comprise the balance sheets as of June 30, 2022 and 2021, the related statements of operations and changes in net assets, functional expenses and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Kentucky Medical Services Foundation, Inc. as of June 30, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits 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 KMSF and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note 2 to the financial statements, effective July 1, 2021, KMSF adopted Accounting Standards Update (2016-02), *Leases (Topic 842)*. 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 KMSF's ability to continue as a going concern within one year after the date that the financial statements are issued or available to be issued.

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 KMSF'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 KMSF'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.

Dean Dotson Allen Ford, PLLC

Lexington, Kentucky
September 19, 2022

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Balance Sheets

June 30, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Assets		
Current assets:		
Investments and interest bearing deposits, current portion	\$ 63,567,174	\$ 49,222,676
Patient accounts receivable	42,013,274	37,817,297
Accounts receivable - Physician Supplemental Payment (PSP)/Directed Payment revenue	-	13,355,880
Other receivables, current portion	5,796,937	6,189,034
Other current assets	<u>1,300,459</u>	<u>1,195,181</u>
Total current assets	112,677,844	107,780,068
Assets limited as to use:		
Dean's academic enrichment funds - limited by agreement	16,722,994	14,243,993
Investments and interest bearing deposits, less current portion	66,195,964	50,056,375
Other receivables, less current portion	696,000	731,441
Right of use asset - operating lease	2,676,848	-
Property and equipment:		
Land and improvements	3,331,198	3,331,198
Buildings	65,447,567	62,579,066
Furniture and equipment	7,310,022	9,291,364
Capitalized software	16,986,574	16,986,574
Right of use buildings under financing lease obligations	70,634,784	71,165,295
Right of use equipment under financing lease obligations	288,994	1,221,032
Construction in progress	<u>906,613</u>	<u>2,542,334</u>
	164,905,752	167,116,863
Less accumulated depreciation	<u>68,991,208</u>	<u>65,179,380</u>
Net property and equipment	<u>95,914,544</u>	<u>101,937,483</u>
Total assets	<u>\$294,884,194</u>	<u>\$274,749,360</u>

	<u>2022</u>	<u>2021</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 6,266,420	\$ 8,092,938
Long-term debt, current portion	598,348	823,452
Finance leases, current portion	3,990,606	3,530,879
Operating leases, current portion	776,952	-
Settlements due to third party payors	569,474	569,474
Patient refunds	4,141,841	1,970,946
Due to the University of Kentucky	63,585,956	583,348
Due to the University of Kentucky - malpractice fund	25,864,775	29,820,301
Due to the College of Medicine departments under departmental plan agreements	<u>95,864,336</u>	<u>131,774,870</u>
Total current liabilities	201,658,708	177,166,208
Long-term debt, net of current portion	15,103,634	15,671,955
Finance leases, net of current portion	50,422,203	55,282,090
Operating leases, net of current portion	<u>1,919,008</u>	<u>-</u>
Total long-term liabilities	<u>67,444,845</u>	<u>70,954,045</u>
Total liabilities	269,103,553	248,120,253
Net assets without donor restrictions:		
Board designated - property and equipment (net of long-term debt, finance leases and operating lease liability)	<u>25,780,641</u>	<u>26,629,107</u>
Total liabilities and net assets	<u>\$294,884,194</u>	<u>\$274,749,360</u>

See accompanying notes.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Statements of Operations and Changes in Net Assets

Years ended June 30, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Revenues and gains:		
Net professional clinical service fee revenue	\$266,722,421	\$252,822,975
Capitation revenue	<u>25,321,347</u>	<u>26,500,561</u>
Net professional clinical service fee revenue and capitation revenue	292,043,768	279,323,536
Lease income	10,403,832	9,496,755
Investment income, net	389,513	204,017
PSP/Directed Payment revenue	-	86,051,793
Federal grant revenue	18,000	-
Other income, net	<u>26,045,223</u>	<u>23,804,758</u>
Total revenues and gains	328,900,336	398,880,859
Expenses:		
Departmental expenses	279,595,854	348,778,929
Operating expenses - business office	6,562,020	7,075,086
UKHMO capitation expenses	6,355,137	7,501,839
Reimbursement to the University of Kentucky for malpractice insurance and expenses attendant to the production of clinical income	3,598,914	6,768,242
Dean's academic enrichment funds	19,920,917	10,316,474
Physicians' fringe benefits	3,805,309	3,591,026
Depreciation expense	7,037,320	10,785,190
Interest expense	2,854,974	3,556,915
Bad debts	<u>18,357</u>	<u>46,104</u>
Total expenses	329,748,802	<u>398,419,805</u>
Change in net assets	(848,466)	461,054
Net assets, beginning of year	<u>26,629,107</u>	<u>26,168,053</u>
Net assets, end of year	\$ <u>25,780,641</u>	\$ <u>26,629,107</u>

See accompanying notes.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Statements of Functional Expenses

Years ended June 30, 2022 and 2021

2022

	UK Healthcare Mission	UK HMO	Administrative	Total
Salaries and wages	\$ 538,720	\$ 112,487	\$ 2,018,514	\$ 2,669,721
Fringe benefits	3,805,309	41,080	729,361	4,575,750
Purchased services	4,339,558	6,371,351	998,871	11,709,780
Supplies	1,803,203	19	139,283	1,942,505
Malpractice expenses	3,598,914	-	-	3,598,914
Rent and lease expenses	2,134,863	-	-	2,134,863
Utilities	1,259,349	-	220,008	1,479,357
Maintenance and repairs	1,780,869	-	1,138	1,782,007
Interest expense	2,854,974	-	-	2,854,974
Depreciation	7,031,281	-	6,039	7,037,320
Bad debts	18,357	-	-	18,357
Other expenses	<u>289,506,656</u>	<u>4,598</u>	<u>434,000</u>	<u>289,945,254</u>
Total expenses	<u>\$ 318,672,053</u>	<u>\$ 6,529,535</u>	<u>\$ 4,547,214</u>	<u>\$ 329,748,802</u>

2021

	UK Healthcare Mission	UK HMO	Administrative	Total
Salaries and wages	\$208,713,301	\$ 407,894	\$ 2,170,753	\$211,291,948
Fringe benefits	19,589,821	90,821	701,849	20,382,491
Purchased services	6,007,525	7,501,839	1,835,205	15,344,569
Supplies	8,453,193	-	239,035	8,692,228
Malpractice expenses	6,768,242	-	-	6,768,242
Rent and lease expenses	1,786,340	-	-	1,786,340
Utilities	1,194,484	-	207,621	1,402,105
Maintenance and repairs	1,375,166	-	6,212	1,381,378
Interest expense	3,556,915	-	-	3,556,915
Depreciation	6,517,995	-	4,267,195	10,785,190
Bad debts	46,104	-	-	46,104
Other expenses	<u>116,969,061</u>	<u>108,305</u>	<u>(95,071)</u>	<u>116,982,295</u>
Total expenses	<u>\$380,978,147</u>	<u>\$ 8,108,859</u>	<u>\$ 9,332,799</u>	<u>\$398,419,805</u>

See accompanying notes.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Statements of Cash Flows

Years ended June 30, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Cash flows from operating activities:		
Change in net assets	\$ (848,466)	\$ 461,054
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	7,037,320	10,785,190
Write off of property and equipment	56,951	-
Gain on disposal of assets	-	(121,747)
Provision for bad debts	18,357	46,104
Amortization of loan fees	5,943	5,943
Increase (decrease) in cash due to changes in:		
Patient accounts receivable	(4,214,334)	(1,676,266)
Accounts receivable - PSP/Directed Payment revenue	13,355,880	8,908,003
Other receivables	427,538	(3,769,172)
Other current assets	(105,278)	198,496
Right of use - operating lease asset	761,493	-
Accounts payable and accrued liabilities	(1,826,518)	(5,779,072)
Right of use - operating lease liability	(742,381)	-
Settlements due to third party payors	-	(55,745)
Patient refunds	2,170,895	438,627
Due to the University of Kentucky	63,002,608	(31,438,113)
Due to the University of Kentucky - malpractice fund	(3,955,526)	6,164,018
Due to the College of Medicine departments under departmental plan agreements	<u>(35,910,534)</u>	<u>70,774,191</u>
Net cash provided by operating activities	39,233,948	54,941,511
Cash flows from investing activities:		
Capital expenditures	(896,565)	(7,564,653)
Increase in investments and interest-bearing deposits, net	(30,484,087)	(39,267,898)
Increase in assets limited as to use, net	(2,479,001)	(4,543,173)
Proceeds on sale of property and equipment	<u>-</u>	<u>527,375</u>
Net cash used in investing activities	(33,859,653)	(50,848,349)
Cash flows from financing activities:		
Repayments on long-term debt	(799,368)	(805,067)
Payments on finance leases	<u>(4,574,927)</u>	<u>(3,288,095)</u>
Net cash used in financing activities	<u>(5,374,295)</u>	<u>(4,093,162)</u>
Net change in cash	\$ <u>-</u>	\$ <u>-</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Statements of Cash Flows, continued

Years ended June 30, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Supplemental cash flow disclosures:		
Cash paid for interest	\$ 2,854,974	\$ 3,556,915
Non cash investing and financing activities:		
Finance lease obligation incurred for property and equipment	(174,767)	-
Additions to ROU assets obtained from:		
Operating lease assets	(3,438,341)	-
Operating lease liabilities	3,438,341	-

See accompanying notes.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements

1. Description of the Organization

Kentucky Medical Services Foundation, Inc. (KMSF) is a non-profit, non-stock corporation. KMSF has been assigned the responsibility to bill, collect and administer all clinical income generated by the physicians of the University of Kentucky (UK) College of Medicine (the College) in accordance with an annual agreement (the Agreement) between KMSF and UK regarding the operation of KMSF. The Agreement was last renewed on July 1, 2022.

Although included in UK's audited financial statements according to *Governmental Accounting Standards*, KMSF is not considered to be an affiliate of UK by Kentucky Revised Statute.

2. Summary of Significant Accounting Policies

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) which required management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The Financial Accounting Standards Board (FASB) promulgates its Accounting Standards Codification as the only source of authoritative accounting principles recognized by the FASB to be applied to nongovernmental entities in the preparation of financial statements in conformity with GAAP. The following is a summary of the significant accounting policies consistently followed by KMSF in the preparation of its financial statements:

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis. Under the terms of the various departmental plans and the Agreement with UK, all income from operations of KMSF, exclusive of changes in the net book value of property and equipment, debt acquired for purchase of property and equipment and changes in amounts designated by the Board of Directors for specific purposes, are payable to the participating departments. Accordingly, such amounts have been included as departmental expenses in the accompanying statements of operations and changes in net assets.

Assets Limited as to Use

Assets limited as to use include cash and investments set aside by the Board of Directors for specific purposes over which the Board retains control and may, at its discretion, subsequently use for other purposes, if any, and cash and investments set aside in accordance with the Agreement between KMSF and UK (see Note 5).

Property and Equipment

KMSF capitalizes all expenditures of \$5,000 or more for moveable equipment and of \$10,000 or more for buildings and building improvements, fixed equipment, infrastructure assets and land improvements. Property and equipment purchased are recorded at cost at the date of acquisition. Depreciation is computed using the straight-line method over the estimated useful life of the depreciable assets, or if leased, the shorter of estimated useful life or leased period, which range from three to forty years. Donated property and equipment, if any, are recorded at estimated fair value at the date of donation.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

2 Summary of Significant Accounting Policies, continued

Income Tax Exemption

KMSF is a non-profit corporation as described in Section 501(c)(3) of the *Internal Revenue Code* (the Code) and is exempt from federal income taxes on related income.

Patient Accounts Receivable and Net Professional Clinical Service Fees

Net professional clinical service fees and patient accounts receivable are reported at the amount that reflects the consideration to which KMSF expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government payors), and others. Generally, KMSF bills the patients and third-party payors several days after the services are performed. Revenue is recognized as the performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by KMSF. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. KMSF believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in KMSF receiving inpatient acute care services. KMSF measures the performance obligation from admission to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Outpatient service revenue is recognized at a point in time when services are provided and KMSF does not believe it is required to provide additional goods or services to the patient.

KMSF estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions based on historical collection experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Agreements with third-party payors provide for payments at amounts less than established charges. Payment agreements with governments and commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges, and prospectively determined rates. Generally patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

2 Summary of Significant Accounting Policies, continued

Patient Accounts Receivable and Net Professional Clinical Service Fees, continued

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and potential exclusion from related programs. There can be no assurance that regulatory authorities will not challenge KMSF's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon KMSF.

Consistent with KMSF's mission, care is provided to patients regardless of their ability to pay. Therefore, KMSF has determined it has provided implicit price concessions to uninsured patients and other uninsured balances, (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represents the difference between amounts billed to patients and the amounts KMSF expects to collect based on its collection history with those patients.

Charity Care

UK provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because UK does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care charges totaled \$7,459,566 and \$5,246,626 for the years ended June 30, 2022 and 2021, respectively. Management has estimated its cost incurred to provide charity care to be approximately \$2,400,000 and \$1,700,000 for the years ended June 30, 2022 and 2021, respectively.

Investments and Investment Income

KMSF has investments in certificates of deposit and other interest bearing deposits, government securities, guaranteed investment contracts and mutual funds as permitted by the Agreement with UK. These investments are stated at fair value or carrying amounts that approximate fair value.

Investment income (including realized and unrealized gains and losses on investments, interest and dividends) is considered by management to be essential to the ongoing operations of KMSF and is reported as other operating revenue.

Functional Allocation of Expenses

The costs of program and supporting services activities have been summarized on a functional basis in the statements of operations and changes in net assets. The statements of functional expenses presents the natural classification detail of expenses by function. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

2 Summary of Significant Accounting Policies, continued

Leases

In February 2016, FASB issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)* to increase transparency and comparability among organizations by requiring all leases to be recognized on KMSF's balance sheet as a right-of-use asset and a lease liability, unless the lease is a short term lease (generally a lease with a term of twelve months or less). At the commencement date of the lease, KMSF is required to recognize: 1) a lease liability for KMSF's obligation to make payments under the lease agreement, measured on a discounted basis; and 2) a right-of-use asset that represents KMSF's right to use, or control the use of, the specified asset for the lease term. Disclosures are also required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

KMSF recognized and measured its leases at July 1, 2021, using the cumulative-effect adjustment option. The adoption of the new leasing standard had a material impact on the balance sheet, but did not have an impact the statement of operations and changes in net assets. The most significant impact was the recognition of right-of-use assets and lease liabilities for operating leases, while the accounting for finance leases remained substantially unchanged. The adoption resulted in no impact to the opening balance of net assets.

The amounts presented in the financial statements for the year ended June 30, 2021, and disclosures related to those amounts, continue to be recognized in accordance with previous guidance (Topic 840).

Upon adoption, KMSF elected to use the practical expedient of applying hindsight in determining the lease term (that is, when considering options to extend or terminate the lease and to purchase the underlying asset) and in assessing impairment of the right-of-use assets.

KMSF determines if an arrangement is a lease at inception of the contract. A contract is or contains a lease if the contract conveys the right to control the use of identified property or equipment (an identified asset) for a period of time in exchange for consideration. For short term leases, (that is a lease that, at the commencement date, has a lease term of 12 months or less and does not include an option to purchase the underlying asset that KMSF is reasonably certain to exercise) a right-of-use (ROU) asset and lease liability is not recognized, instead lease payments are recognized in the statement of income and changes in net assets on a straight-line basis over the lease term and any variable lease payments are recognized when the obligation for those payments is incurred.

Operating leases are included in operating lease ROU assets and operating lease liabilities (current and long-term) in the balance sheet. Finance leases are included in property and equipment, and finance lease liabilities (current and long-term) in the balance sheet. Operating and finance lease ROU assets and liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. ROU assets include any lease payments made and excludes lease incentives.

As most of KMSF's leases do not provide an implicit rate, KMSF uses an incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at the commencement date.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

2 Summary of Significant Accounting Policies, continued

Leases, continued

Lease terms may include options to extend or terminate the lease. Where management concludes that it is reasonably certain that a renewal or termination option will be exercised, that renewal period or termination option is used to determine the lease term and the related payments that are reflected in the ROU asset and lease liability.

KMSF's leases include fixed rental payments and some leases also include variable rental payments. In addition, KMSF also commonly enters into leases under which the lease payments increase at pre-determined dates. Variable lease payments and increases in lease payments are only included in measuring ROU assets and lease liabilities if they depend on an index or a rate, or are in substance fixed payments.

Optional payments to purchase the underlying asset are included in the measurement of the ROU assets and lease liabilities if management is reasonably certain to exercise the purchase option.

Lease expense for operating lease payments is recognized on a straight-line basis over the lease term. Finance lease ROU assets are amortized over the shorter of their estimated useful life or the term of the lease. Interest paid on finance leases for the year ended June 30, 2022 was \$2,335,723.

Lease agreements with lease and non-lease components are generally accounted for separately based upon the standalone price of the separate lease and non-lease components at the commencement date of the lease. KMSF has elected the practical expedient not to separate lease and nonlease components for certain of KMSF's leases.

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through September 19, 2022, the date that the financial statements were available to be issued.

New Accounting Pronouncements

In September 2020, the FASB issued ASU 2020-07, *Not-for-Profit Entities (Topic 958), Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*. The FASB issued the update in an effort to improve transparency in reporting nonprofit gifts-in-kind, by requiring not-for-profit entities to present contributed nonfinancial assets as a separate line item in the statement of activities and by enhancing the disclosures about the valuation of in-kind contributions and their use in other programs or activities. The ASU requires adoption of the new presentation and disclosures to be applied retrospectively. The updated standard will be effective for KMSF for the year ending June 30, 2023. KMSF is currently evaluating the effect that the new standard will have on its financial statements.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

3. Liquidity and Availability

The following table reflects KMSF's current financial assets as of June 30, 2022 and 2021, reduced by amounts that are not available to meet general expenditures within one year of the statement of financial position date because of contractual restrictions or internal board designations. There were no net assets with donor restrictions at June 30, 2022 and 2021.

	<u>2022</u>	<u>2021</u>
Investments and interest bearing deposits, current portion	\$ 63,567,174	\$ 49,222,676
Patient accounts receivable, net	42,013,274	37,817,297
Accounts receivable - Physician Supplemental Payment (PSP) revenue	-	13,355,880
Other receivables, current portion	5,796,937	6,189,034
Other current assets	<u>1,300,459</u>	<u>1,195,181</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$112,677,844</u>	<u>\$107,780,068</u>

KMSF had approximately \$40,000,000 and \$20,000,000 as of June 30, 2022 and 2021, respectively, in short-term certificates of deposit with maturity terms of six months. These are classified under long-term investments on the balance sheets; however, they are available to be redeemed if necessary to meet general expenditures within one year of the statement of financial position date.

KMSF also maintains a designated investment portfolio for the malpractice fund. The market value of the portfolio as of June 30, 2022 and 2021 was \$25,864,775 and \$29,820,301, respectively. The portfolio is classified under long-term investments on the balance sheets, however, it is available to meet the financial obligation due to the University of Kentucky for the Malpractice Fund, listed at an equal value within current liabilities.

4. Other Receivables

KMSF makes loans to physicians they anticipate will become employees of UK. A portion of these loans will be forgiven each year, up to the maximum amount of the loan, if certain conditions, such as serving as a full-time physician and faculty member of UK, are met by the borrower. If the conditions for forgiveness are not met, the entire principal balance is payable by the borrower, including accrued interest at the rate of 1% above prime. The total amount outstanding on such loans was \$1,264,108 and \$1,201,217 as of June 30, 2022 and 2021, respectively. As of June 30, 2022 and 2021, also included in other receivables are various amounts due to UK in the amounts of \$4,173,638 and \$2,586,472, respectively.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

5. Academic Enrichment Funds

In accordance with the Agreement with UK effective July 1, 2021, KMSF is required to maintain a separate bank account, which represents contributions, less cumulative disbursements by the Dean of the College of Medicine. During the year ended June 30, 2022, KMSF transferred \$22,000,0000 plus 1% of each department's total monthly expenses of \$3,838,159 to the Dean's Academic Enrichment account. During the year ended June 30, 2021, KMSF contributed 8% of the cumulative clinical income collected to this account.

The funds in the account are for the use of the Dean of the College of Medicine for the enrichment of the program of the College or for related purposes at his/her sole discretion. The Dean's Fund supports the missions of UK and UK HealthCare by providing financial support of activities such as research, education, departmental and program development. In 2022 and 2021, the amount provided to UK for research and education was \$19,920,917 and \$10,316,474, respectively. In 2022 and 2021, \$1,208,765 and \$996,937, respectively, were expended in the Dean's operations for faculty and staff salaries, benefits and other operating expenses and are included in departmental expenses on the statements of operations and changes in net assets.

The cash balance in the Dean's account as of June 30, 2022 and 2021 was \$16,722,994 and \$14,243,993 respectively, and is included as part of the liability payable under the Departmental Plan Agreements.

6. Investments and Interest Bearing Deposits

Investments and interest bearing deposits, including accrued interest, are as follows as of June 30:

	<u>2022</u>	<u>2021</u>
Interest bearing deposits and government securities	\$ 104,258,012	\$ 69,666,532
Fixed income securities	7,008,676	8,099,752
Equity securities and equity security mutual funds	<u>18,496,450</u>	<u>21,512,767</u>
Total investments and interest bearing deposits	<u>\$ 129,763,138</u>	<u>\$ 99,279,051</u>

The components of investment income from investments and interest bearing deposits for 2022 and 2021 consist of \$389,513 and \$204,017, respectively, of realized and unrealized gains and losses, dividends and interest.

Management has elected to follow Accounting Research Bulletin 43 in the presentation of current and non-current investments as follows:

	<u>2022</u>	<u>2021</u>
Current investments	\$ 63,567,174	\$ 49,222,676
Non-current investments	<u>66,195,964</u>	<u>50,056,375</u>
Total investment and interest bearing deposits	<u>\$ 129,763,138</u>	<u>\$ 99,279,051</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

7. Fair Value Measurements

KMSF classifies its investments based on a hierarchy consisting of: Level 1 (valued using quoted prices from active markets for identical assets), Level 2 (not traded on an active market but for which observable market inputs are readily available), and Level 3 (valued based on significant unobservable inputs). The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis:

Interest bearing deposits and government securities: Valued at cost which approximates fair value.

Common stocks and foreign equities: Valued at the closing price reported on the active market on which the individual securities are traded.

Real estate investment partnership: Valued at cost, which approximates fair value.

Real estate investment trust: Valued at the closing price reported on the active market on which the individual securities are traded.

Mutual funds: Mutual funds based in equity securities are valued at the daily closing price as reported by the fund. These mutual funds held by KMSF are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. These mutual funds are deemed to be actively traded.

Fixed income securities: Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.

There have been no changes in the valuation methodologies used at June 30, 2022 and 2021.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while KMSF's management believes the valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

7. Fair Value Measurements, continued

The following tables set forth by level, within the fair value hierarchy, KMSF's assets and liabilities at fair value:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>June 30, 2022</u>				
Interest bearing deposits and government securities	\$ 104,258,012	\$ -	\$ -	\$ 104,258,012
Common stocks and foreign equities	10,220,986	-	-	10,220,986
Real estate investment trust	306,403	-	-	306,403
Absolute return strategy	833,446	-	-	833,446
Real estate investment partnership	-	1,241,458	-	1,241,458
Mutual funds:				
Taxable/fixed income	4,182,050	-	-	4,182,050
International	3,786,604	-	-	3,786,604
Mid cap	895,212	-	-	895,212
Small cap	<u>1,212,341</u>	<u>-</u>	<u>-</u>	<u>1,212,341</u>
Total mutual funds	10,076,207	-	-	10,076,207
Fixed income securities:				
Aaa credit rating	-	770,581	-	770,581
Aa2 credit rating	-	142,694	-	142,694
Aa3 credit rating	-	255,701	-	255,701
A1 credit rating	-	687,472	-	687,472
A2 credit rating	-	423,453	-	423,453
A3 credit rating	-	446,906	-	446,906
NR credit rating	<u>-</u>	<u>99,819</u>	<u>-</u>	<u>99,819</u>
Total fixed income securities	<u>-</u>	<u>2,826,626</u>	<u>-</u>	<u>2,826,626</u>
Total investments	<u>\$ 125,695,054</u>	<u>\$ 4,068,084</u>	<u>\$ -</u>	<u>\$ 129,763,138</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

7. Fair Value Measurements, continued

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>June 30, 2021</u>				
Interest bearing deposits and government securities	\$ 69,666,532	\$ -	\$ -	\$ 69,666,532
Common stocks and foreign equities	12,463,883	-	-	12,463,883
Real estate investment trust	342,320	-	-	342,320
Real estate investment partnership	-	853,896	-	853,896
Mutual funds:				
Taxable/fixed income	4,558,325	-	-	4,558,325
International	5,327,713	-	-	5,327,713
Mid cap	1,270,397	-	-	1,270,397
Small cap	<u>1,254,558</u>	<u>-</u>	<u>-</u>	<u>1,254,558</u>
Total mutual funds	12,410,993	-	-	12,410,993
Fixed income securities:				
Aaa credit rating	-	1,092,410	-	1,092,410
Aa2 credit rating	-	693,021	-	693,021
Aa3 credit rating	-	726,380	-	726,380
A1 credit rating	-	376,993	-	376,993
A2 credit rating	-	263,520	-	263,520
A3 credit rating	-	288,096	-	288,096
NR credit rating	<u>-</u>	<u>101,007</u>	<u>-</u>	<u>101,007</u>
Total fixed income securities	<u>-</u>	<u>3,541,427</u>	<u>-</u>	<u>3,541,427</u>
Total investments	<u>\$ 94,883,728</u>	<u>\$ 4,395,323</u>	<u>\$ -</u>	<u>\$ 99,279,051</u>

To assess the appropriate classification of assets and liabilities within the fair value hierarchy, the availability of market data is monitored. Changes in economic conditions or valuation techniques may require the transfer of assets and liabilities from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. KMSF's management evaluates the significance of transfers between levels based upon the nature of the assets and liabilities and size of the transfer relative to total net assets. There were no transfers of assets or liabilities from one fair value level to another during the years ended June 30, 2022 and 2021.

8. Settlements Due to Third Party Payors

KMSF has accrued settlements due to third party payors of approximately \$570,000 as of both June 30, 2022 and 2021. This liability represents amounts due to the federal government and insurance companies for payments KMSF has received but which need to be refunded due to various reasons within the revenue cycle.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

9. Long-Term Debt and Finance Leases

As of June 30, 2022 and 2021, long-term debt and finance lease obligations consisted of the following:

	<u>2022</u>	<u>2021</u>
Finance lease obligation, maturing August 2034, bearing interest at 5.0%, collateralized by property with a net book value of \$27,221,184, payments of \$261,584 per month (payment amounts increase annually as defined by the agreement).	\$ 30,463,042	\$ 31,903,971
Finance lease obligation, maturing March 2037, bearing interest at 4.75% for the base rent, and 7.5% for the tenant improvements portion, collateralized by property with a net book value of \$12,260,608, payments of \$111,181 per month (payment amounts per month increase every fifth year of the finance lease obligation).	13,754,345	15,446,853
County of Clark, Kentucky Healthcare Revenue Bonds, Series 2017, accruing interest at a rate equal to 4.24% and 2.94% as of June 30, 2022 and 2021, respectively, due in monthly principal and interest payments of \$55,374 and maturing in April 2037.	7,974,778	8,377,569
County of Scott, Kentucky Healthcare Revenue Bonds, Series 2017, accruing interest at a rate equal to 4.77% and 2.94% as of June 30, 2022 and 2021, respectively, due in monthly principal and interest payments of \$54,016 and maturing in April 2037.	7,815,862	8,212,440
Finance lease obligation, maturing June 2027, bearing interest at 4.25%, collateralized by property with a net book value of \$4,120,628, payments of \$93,659 per month (increasing by 2% every subsequent lease year).	5,269,102	6,110,772
Finance lease obligation, maturing June 2028, bearing interest at 4.25%, collateralized by property with a net book value of \$3,997,646, payments of \$69,523 per month (increasing by 2.75% every subsequent lease year). KMSF has the option to renew for three additional five year lease terms.	4,725,604	5,308,250

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

9. Long-Term Debt and Finance Leases, continued

	<u>2022</u>	<u>2021</u>
Finance lease obligation, maturing April 2024, bearing interest at 5.5%, collateralized by leased equipment with a net book value of \$22,569, payments of \$1,240 per month.	25,949	43,123
Finance lease obligation, maturing November 2024, collateralized by property with a net book value of \$208,377, payments were \$1,418 weekly until March 2022, then became \$6,147 per month.	<u>174,767</u>	<u>-</u>
Total long-term debt and finance leases	70,203,449	75,402,978
Less capitalized loan fees, net	<u>88,658</u>	<u>94,602</u>
	70,114,791	75,308,376
Less current portion	<u>4,588,954</u>	<u>4,354,331</u>
Long-term debt and finance leases, net of current portion	<u>\$ 65,525,837</u>	<u>\$ 70,954,045</u>

Scheduled principal repayments on bonds and payments on finance lease obligations are as follows:

Year ending June 30,	<u>Bonds</u>	Finance Lease <u>Obligations</u>
2023	\$ 604,292	\$ 6,534,903
2024	630,465	6,609,127
2025	661,597	6,632,100
2026	692,310	6,688,592
2027	724,453	6,774,123
Thereafter	<u>12,477,523</u>	<u>38,601,834</u>
	<u>\$ 15,790,640</u>	71,840,679
Less amount representing interest under finance lease obligations		<u>17,427,870</u>
		<u>\$ 54,412,809</u>

Interest expense was \$2,854,974 and \$3,556,915 for the years ended June 30, 2022 and 2021, respectively.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

10. Net Professional Clinical Service Fees and Capitation Revenue

UK and KMSF have agreements with third-party payors that provide for payments at amounts different from their established rates. Contractual adjustments represent the difference between billing at established rates and amounts reimbursed by third-party payors.

Revenue recognized at a point in time includes capitation revenue, PSP/directed payment revenue, retail drug sales, grant revenue, and other revenues. Revenue recognized over time include professional clinical service fee revenue (including associated drug sales).

Net revenue recognized by timing of revenue recognition for the years ended June 30, 2022 and 2021, is as follows:

	<u>2022</u>	<u>2021</u>
Revenue recognized at a point in time	\$ 56,359,415	\$ 140,774,265
Revenue recognized over time	261,747,576	248,405,822
Lease income	10,403,832	9,496,755
Investment income, net	<u>389,513</u>	<u>204,017</u>
 Total net revenue	 <u>\$ 328,900,336</u>	 <u>\$ 398,880,859</u>

11. PSP and Directed Payment Revenue

During 2021, KMSF received \$86,051,793 in PSP and directed payment revenue from the University of Kentucky. These funds are used to supplement KMSF's professional clinical service fees and to support the ongoing operations of KMSF. KMSF did not receive any of these payments in 2022.

12. Other Income

Other income consists of the following for the years ended June 30, 2022 and 2021:

	<u>2022</u>	<u>2021</u>
Medical and administrative services contractual income	\$ 24,263,314	\$ 21,929,524
EHR meaningful use	-	195,500
Prior years revenue adjustments	187,202	353,576
Shared savings payments	1,012,692	130,821
Royalty and honoraria income	51,853	133,948
Payor quality incentives	361,092	577,204
Other income	<u>169,070</u>	<u>484,185</u>
 Total other income	 <u>\$ 26,045,223</u>	 <u>\$ 23,804,758</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

13. Lessor Activities

KMSF leases office space to UK as well as other non-related entities. The lease contracts with UK vary with remaining terms ranging from one year to five years with optional extensions as provided by the various agreements. The lease contracts with the non-related entities vary with remaining terms ranging from less than one year to forty-eight years. KMSF received \$10,292,482 and \$9,384,504 in lease income from UK and \$111,350 and \$112,251 from other non-related entities in 2022 and 2021, respectively.

The following is a schedule of future minimum rentals under the noncancellable leases at June 30, 2022 for the next five years:

Year ending June 30,	
2023	\$ 10,372,557
2024	7,142,966
2025	6,154,646
2026	6,094,329
2027	6,094,329
Thereafter	<u>8,097,651</u>
	<u>\$ 43,956,478</u>

14. Lessee Activities

KMSF has operating and finance leases for equipment and facilities. The leases expire over various terms through 2027, some of which include the option to extend the leases. See Note 9 for information on finance leases.

KMSF had \$887,144 and \$1,786,340 of fixed rent cost for the years ended June 30, 2022 and 2021, respectively, included in departmental expenses on the statement of operations and changes in net assets.

Year ending June 30,	
2023	\$ 851,337
2024	614,908
2025	560,898
2026	488,740
2027	246,117
Thereafter	<u>88,812</u>
	<u>\$ 2,850,812</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

15. Medical Malpractice Insurance

KMSF is self-insured, along with UK, for malpractice claims. On an annual basis, the malpractice liability is actuarially determined at a consolidated basis using claims data from UK and KMSF. UK informs KMSF of their portion of the overall liability as well as their funding requirements to maintain appropriate funding levels. KMSF maintains their portion of the malpractice fund investments. Management believes the malpractice self-insurance fund is adequate to cover any losses.

16. Contingencies

KMSF is currently involved in litigation and/or regulatory investigations. KMSF's involvement typically arises either in the course of KMSF's business or in KMSF's role as a support organization for UK, and it is possible that the litigation and/or regulatory investigations could result in a material adverse effect on KMSF's future financial position or results from operations. Apart from matters where KMSF's involvement is part of such support role, management estimates these matters will be resolved without material adverse effect on KMSF's future financial position or results from operations.

17. Concentrations of Credit Risk

UK and KMSF grant credit without collateral to their patients, most of whom are area residents and are insured under third-party payor arrangements. The mix of receivables from patients and third-party payors at June 30, 2022 and 2021, was as follows:

	<u>2022</u>	<u>2021</u>
Other third-party payors	28 %	26 %
Patients	21	9
Medicaid	21	30
Blue Cross	16	16
Medicare	<u>14</u>	<u>19</u>
	<u>100 %</u>	<u>100 %</u>