



 University of  
Kentucky®

Mining Engineering Foundation, Inc.  
2016 Financial Statements

**University of Kentucky**  
**Mining Engineering Foundation, 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  
University of Kentucky  
Mining Engineering Foundation, 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 the University of Kentucky Mining Engineering 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 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

The University of Kentucky Mining Engineering 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, 2016 and 2015. 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 decreased \$86,426 or 4.4% primarily due to a decrease in endowment investments of \$91,729 offset by an increase in cash and cash equivalents of \$5,303.
- Total liabilities decreased \$3,305 due to a decrease in vendors and contractors payable of \$10,274 offset by an increase in accrued expenses for payroll of \$6,969.
- Net position decreased \$83,121 to \$1,850,417 which represented 99.6% of total assets.
- Operating revenues decreased \$63,453 or 165.0% due to an investment loss.
- Operating expenses decreased \$2,183 or 3.4% due to a decrease in instructional expenses of \$6,546 offset by an increase in grants to the University of Kentucky of \$4,363.

## Using the Financial Statements

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

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

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

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

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

## Reporting Entity

The University of Kentucky Mining Engineering Foundation, Inc. is a not-for-profit Kentucky corporation formed to establish a continuing partnership between the University of Kentucky (the University) and the mining industry in the Commonwealth of Kentucky for the enhancement and improvement of the Mining Engineering Department of the College of Engineering. 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 or staff and/or are appointed by the President of the University, and certain officers of the Foundation are officers of the University.

## Condensed Financial Information

### Statements of Net Position

	2016	2015	2014
<b>ASSETS</b>			
Current assets	\$ 26,005	\$ 20,702	\$ 5,001
Noncurrent assets	1,832,571	1,924,300	1,949,288
Total assets	<u>1,858,576</u>	<u>1,945,002</u>	<u>1,954,289</u>
<b>LIABILITIES</b>			
Current liabilities	8,159	11,464	-
Total liabilities	<u>8,159</u>	<u>11,464</u>	<u>-</u>
<b>NET POSITION</b>			
Restricted			
Nonexpendable	661,626	658,276	653,826
Expendable	1,188,791	1,275,262	1,300,463
Total net position	<u>\$ 1,850,417</u>	<u>\$ 1,933,538</u>	<u>\$ 1,954,289</u>

**Assets.** As of June 30, 2016, the Foundation's assets totaled \$1,858,576. Endowment investments represented 98.6% of the Foundation's assets.

Total assets decreased \$86,426 during the year ended June 30, 2016. Endowment investments decreased \$91,729 due to an investment loss, spending distribution, and management fee. The endowment pool posted a total loss of 1.8% for fiscal year 2016 compared to a total gain of 1.59% in the prior year.

**Liabilities.** At June 30, 2016, the Foundation liabilities totaled \$8,159.

**Net Position.** Net position at June 30, 2016 totaled \$1,850,417, or 99.6% of total assets, all of which were restricted.

Total net position decreased \$83,121 during the year ended June 30, 2016. Nonexpendable restricted net position increased \$3,350 due to additions to permanent endowments. Expendable restricted net position decreased \$86,471 due to an investment loss, education and general expenditures, and grants to the University.

**2015 Versus 2014.** Total net position decreased \$20,751 from June 30, 2014 to June 30, 2015. Nonexpendable restricted net position increased \$4,450 due to additions to permanent endowments. Expendable restricted net position decreased \$25,201 primarily due to education and general expenditures and grants to the University in excess of investment income.

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

	2016	2015	2014
<b>OPERATING REVENUES (LOSSES)</b>			
Operating revenues (losses)	\$ (24,997)	\$ 38,456	\$ 267,773
Total operating revenues (losses)	<u>(24,997)</u>	<u>38,456</u>	<u>267,773</u>
<b>OPERATING EXPENSES</b>			
Educational and general	52,303	58,849	52,366
Grants to the University of Kentucky - noncapital	9,171	4,808	6,515
Total operating expenses	<u>61,474</u>	<u>63,657</u>	<u>58,881</u>
<b>NET INCOME (LOSS) FROM OPERATIONS</b>	<u>(86,471)</u>	<u>(25,201)</u>	<u>208,892</u>
<b>NONOPERATING REVENUES</b>			
Additions to permanent endowments	3,350	4,450	3,250
Total nonoperating revenues	<u>3,350</u>	<u>4,450</u>	<u>3,250</u>
Total increase (decrease) in net position	(83,121)	(20,751)	212,142
<b>Net position, beginning of year</b>	<u>1,933,538</u>	<u>1,954,289</u>	<u>1,742,147</u>
<b>Net position, end of year</b>	<u><u>\$ 1,850,417</u></u>	<u><u>\$ 1,933,538</u></u>	<u><u>\$ 1,954,289</u></u>

**2016.** The Foundation had operating revenues of (\$24,997) due to realized and unrealized losses on endowment investments. The endowment pool posted a total loss of 1.8% for fiscal year 2016 compared to a total gain of 1.59% for fiscal 2015.

Operating expenses totaled \$61,474, of which 85.1% was used for educational and general expenses related to instruction, and the remaining 14.9% was used to provide grants to the University for noncapital purposes.

**2015 Versus 2014.** Net operating income decreased \$234,093 when comparing fiscal year 2015 to fiscal year 2014. Total operating revenue decreased \$229,317 due to a decline in gains on endowment investments. Total operating expenses increased \$4,776 primarily in education and general expenses offset by a small decrease in grants to the University for capital and noncapital purposes.

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

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

### Statements of Cash Flows

	2016	2015	2014
<b>CASH PROVIDED (USED) BY:</b>			
Operating activities	\$ (64,779)	\$ (51,641)	\$ (66,863)
Noncapital financing activities	3,350	4,450	3,250
Investing activities	66,732	63,444	61,649
Net increase (decrease) in cash and cash equivalents	5,303	16,253	(1,964)
<b>Cash and cash equivalents, beginning of year</b>	20,702	4,449	6,413
<b>Cash and cash equivalents, end of year</b>	\$ 26,005	\$ 20,702	\$ 4,449

**2016.** Cash payments for operating activities were primarily reimbursements to the University for salaries and benefits totaling \$38,695 and payments to vendors and contractors for goods and services of \$16,913.

Cash receipts in the noncapital financing activities group relate to private gifts to the permanent endowment of \$3,350.

Cash provided by investing activities includes \$578,150 from the sale of investments and interest and dividend income of \$21,547, net of \$532,965 expended on the purchase of investments.

**2015 Versus 2014.** In fiscal year 2015 cash increased \$16,253 compared to a decrease of \$1,964 in 2014. The increase in cash flows was primarily related to an decrease in cash used by operating activities offset by cash provided by investing activities and noncapital financing activities.

### **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, 2016.

### **Factors Impacting Future Periods**

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



**UNIVERSITY OF KENTUCKY MINING ENGINEERING FOUNDATION, INC.**  
**A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY**  
**STATEMENTS OF NET POSITION**  
**JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 26,005	\$ 20,702
Total current assets	<u>26,005</u>	<u>20,702</u>
<b>Noncurrent Assets</b>		
Endowment investments	1,832,571	1,924,300
Total noncurrent assets	<u>1,832,571</u>	<u>1,924,300</u>
Total assets	<u>1,858,576</u>	<u>1,945,002</u>
<b>LIABILITIES</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	8,159	11,464
Total current liabilities	<u>8,159</u>	<u>11,464</u>
Total liabilities	<u>8,159</u>	<u>11,464</u>
<b>NET POSITION</b>		
<b>Restricted</b>		
Nonexpendable	661,626	658,276
Expendable	1,188,791	1,275,262
Total restricted	<u>1,850,417</u>	<u>1,933,538</u>
Total net position	<u>\$ 1,850,417</u>	<u>\$ 1,933,538</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY MINING ENGINEERING FOUNDATION, INC.  
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY  
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
<b>OPERATING REVENUES (LOSSES)</b>		
Investment income (loss)	\$ (24,997)	\$ 38,456
Total operating revenues (losses)	<u>(24,997)</u>	<u>38,456</u>
<b>OPERATING EXPENSES</b>		
Educational and general:		
Instruction	52,303	58,849
Total educational and general	<u>52,303</u>	<u>58,849</u>
Grants to (from) the University of Kentucky for noncapital purposes	9,171	4,808
Total operating expenses	<u>61,474</u>	<u>63,657</u>
Net income (loss) from operations	<u>(86,471)</u>	<u>(25,201)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Additions to permanent endowments	3,350	4,450
Total other nonoperating revenues (expenses)	<u>3,350</u>	<u>4,450</u>
Increase (decrease) in net position	(83,121)	(20,751)
<b>NET POSITION, beginning of year</b>	<u>1,933,538</u>	<u>1,954,289</u>
<b>NET POSITION, end of year</b>	<u>\$ 1,850,417</u>	<u>\$ 1,933,538</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY MINING ENGINEERING FOUNDATION, 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>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Payments to vendors and contractors	\$ (16,913)	\$ (22,743)
Salaries, wages and benefits reimbursements to the University of Kentucky	(38,695)	(24,090)
Grants (to) from the University of Kentucky for noncapital purposes	(9,171)	(4,808)
Net cash provided (used) by operating activities	<u>(64,779)</u>	<u>(51,641)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Private gifts for endowment purposes	<u>3,350</u>	<u>4,450</u>
Net cash provided (used) by noncapital financing activities	<u>3,350</u>	<u>4,450</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales and maturities of investments	578,150	384,974
Interest and dividends on investments	21,547	20,381
Purchase of investments	<u>(532,965)</u>	<u>(341,911)</u>
Net cash provided (used) by investing activities	<u>66,732</u>	<u>63,444</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	5,303	16,253
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>20,702</u>	<u>4,449</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 26,005</u>	<u>\$ 20,702</u>
<b>Reconciliation of net income (loss) from operations</b>		
<b>to net cash provided (used) by operating activities:</b>		
Net income (loss) from operations	\$ (86,471)	\$ (25,201)
Adjustments to reconcile net income (loss) from operations		
to net cash provided (used) by operating activities:		
Investment (income) loss	24,997	(38,456)
Change in assets and liabilities:		
Due from the University of Kentucky	-	552
Accounts payable and accrued liabilities	<u>(3,305)</u>	<u>11,464</u>
<b>Net cash provided (used) by operating activities</b>	<u>\$ (64,779)</u>	<u>\$ (51,641)</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY  
MINING ENGINEERING FOUNDATION, 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**

The University of Kentucky Mining Engineering 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 mining industry of the Commonwealth of Kentucky (the Commonwealth) for the enhancement and improvement of the Mining Engineering Department of the College of Engineering. 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 or staff 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 Foundation's permanent endowment funds.
  - Expendable* – Net position whose use by the Foundation is subject to externally imposed stipulations that can be fulfilled by actions of the Foundation pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net position whose use by the Foundation is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

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

**Summary of Significant Accounting Policies**

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

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

Pooled Endowment Funds. All endowments are managed in a consolidated investment pool, which consists of more than 2,100 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 makes expenditure decisions in accordance with UPMIFA and donor gift agreements. UPMIFA prescribes guidelines for expenditure of a donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations) and focuses on the entirety of a donor-restricted endowment fund, that is, both the original gift amount(s) and net appreciation. In accordance with the standard of prudence prescribed by UPMIFA and consistent with industry standards, the University has adopted a spending policy with the long-term objective to maintain the purchasing power of each endowment and provide a predictable and sustainable level of income to support current operations.

The adopted spending policy is a “hybrid” policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending is calculated by taking a weighted average comprising 60% of the prior year’s spending, adjusted for inflation, and 40% of the amount that results when the target annual spending rate of four percent is applied to the average market value of the endowment over the preceding 36 months. The spending amount determined by the formula is constrained so that the calculated rate is at least three percent, and not more than six percent, of the current endowment market value.

The University also utilizes an endowment management fee to support internal management and fundraising costs related to the endowment. The University’s annual endowment management fee was 0.50% and 0.25% for the years ended June 30, 2016 and 2015, respectively.

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

The amount of gross spending policy distribution in accordance with the University’s endowment spending policy was \$62,921 and \$61,300 for the years ended June 30, 2016 and 2015, respectively.

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



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. The accompanying financial statements include estimates for items such as accrued expenses for payroll and other liability accounts.

## 2. DEPOSITS AND INVESTMENTS

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

	<u>2016</u>	<u>2015</u>
Cash on deposit with the University	\$ 26,005	\$ 20,702
Investment in University pooled endowment fund	<u>1,832,571</u>	<u>1,924,300</u>
Total	<u>\$ 1,858,576</u>	<u>\$ 1,945,002</u>

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

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

The investment in University pooled endowment fund is derived based on the per unit calculation as described in footnote 1, thus is deemed to be a level 3 investment. For more information regarding the fair value measurements, refer to the University's financial statements, footnote 2. There have been no significant changes in the valuation techniques during the year ended June 30, 2016.

The composition of the University's pooled endowment fund based upon fair value at June 30, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	0.7%	0.4%
Common and preferred stock	3.1%	3.5%
Corporate fixed income funds	0.5%	0.7%
Government agency fixed income funds	0.2%	0.2%
Pooled absolute return funds	11.5%	10.0%
Pooled diversified inflation strategies	7.5%	-
Pooled equity funds	24.3%	26.2%
Pooled fixed income funds	5.9%	7.3%
Pooled global tactical asset allocation funds	6.8%	7.2%
Pooled long/short equity funds	13.6%	14.2%
Pooled private equity funds	14.4%	12.8%
Pooled real estate funds	10.6%	8.5%
Pooled real return funds	-	8.3%
U.S. Treasury fixed income	0.9%	0.7%
Total	<u>100.0%</u>	<u>100.0%</u>

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:

- Cash on deposit with the University, which the University invests in deposits with banks and the Commonwealth. During the fiscal year ended June 30, 2015, the University also invested in repurchase agreements with banks and the Commonwealth.
- 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 established by the Treasurer of the University.

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

Deposit and Investment Risks. The Foundation's deposits and investments are exposed to various risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could affect the investment amounts in the Statements of Net Position.

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing the Foundation to experience a loss of principal. As a means of limiting its exposure to losses arising from credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Cash 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). The Foundation's deposits are insured up to \$250,000 at each FDIC insured institution. Credit risk on deposits in excess of FDIC coverage and on repurchase agreements with local banks is mitigated by 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 was 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 was 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.

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 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.
- 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, 2016, the Foundation had no underlying investments in any one issuer which represents 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 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 core-plus fixed income managers are limited to a duration that is within two years of the duration of the Barclays Aggregate Bond Index and unconstrained fixed income strategies have been implemented to further protect against interest rate risk.

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

The Foundation's exposure to foreign currency risk derives from certain endowment investments of the University's pooled endowment fund. The University's investment policy allows fixed income managers to invest a portion of their portfolios in non-U.S. securities. Additionally, the investment policy allows various pooled fund managers to invest in accordance with the guidelines established in each individual fund's prospectus, which allows for investment in non-U.S. securities. Endowment managers are permitted to use derivative instruments to limit foreign currency risk.

### 3. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	2016	2015
Payable to vendors and contractors	\$ -	\$ 10,274
Accrued expenses for payroll	8,159	1,190
Total	<u>\$ 8,159</u>	<u>\$ 11,464</u>

### 4. INVESTMENT INCOME (LOSS)

Components of investment income (loss) for the years ended June 30, 2016 and 2015 are as follows:

	2016	2015
Interest and dividends earned on endowment investments	\$ 21,483	\$ 20,376
Realized and unrealized gains and (losses) on endowment investments	(46,544)	18,075
Interest on cash and non-endowment investments	64	5
Total	<u>\$ (24,997)</u>	<u>\$ 38,456</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 2015 to 2016. Settlements have not exceeded insurance coverage during the past three years.

### 6. TRANSACTIONS WITH THE UNIVERSITY

Grants to the University are for endowment management fees. All salaries, wages and benefits reimbursements to the University represent charges for University employees.

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