2012 Financial Statements

Mining Engineering Foundation, Inc.

UNIVERSITY OF
KENTUCKY®

University of Kentucky
Mining Engineering Foundation, Inc.
A Component Unit of the University of Kentucky

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors
University of Kentucky
Mining Engineering Foundation, Inc.
Lexington, Kentucky

We have audited the accompanying basic financial statements 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, as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the Foundation's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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.

Our audit was performed 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 audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

BKD, LLP

September 28, 2012

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, 2012 and 2011. 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 $86,592 or 5.0% due to a decrease in the market value of endowment investments of $93,688 offset by an increase of $7,096 in cash and cash equivalents. Net assets represented nearly 100% of total assets.

Using the Annual Report

This financial report consists of three financial statements: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; 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 Assets; Statement of Revenues, Expenses and Changes in Net Assets; 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 assets (the difference between assets and liabilities) are one sign of the Foundation’s financial health. Over time, increases or decreases in net assets indicate the improvement or erosion of the Foundation’s financial health.

The Statement of Net Assets includes all assets and liabilities. 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 Assets 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 Assets

	2012	2011	2010
ASSETS			
Current assets	$ 14,819	$ 15,909	$ 5,204
Noncurrent assets	1,624,238	1,709,740	1,509,859
Total assets	1,639,057	1,725,649	1,515,063
LIABILITIES			
Current liabilities	148	1,726	1,659
Total liabilities	148	1,726	1,659
NET ASSETS			
Restricted			
Nonexpendable	650,226	649,851	649,451
Expendable	988,683	1,074,072	863,953
Total net assets	$ 1,638,909	$ 1,723,923	$ 1,513,404

Assets. As of June 30, 2012, the Foundation's assets totaled $1,639,057. Endowment investments represented 96.0% of the Foundation's assets. Total assets decreased $86,592 during the year ended June 30, 2012, due primarily to a decline in the market value of endowment investments. The endowment pool posted a total loss of .85% for fiscal year 2012 compared to a gain of 18.7% in the prior year.

Liabilities. At June 30, 2012, the Foundation had minimal liabilities of $148.

Net Assets. Net assets at June 30, 2012 totaled $1,638,909, or nearly 100% of total assets, all of which were restricted net assets.

Total net assets decreased $85,014 during the year ended June 30, 2012. Expendable restricted net assets decreased $85,389 primarily because of an endowment loss due to a decline in the capital markets.

2011 Versus 2010. Total net assets increased $210,519 from June 30, 2010 to June 30, 2011. Expendable restricted net assets increased $210,119 primarily because of an endowment gain due to an upturn in the capital markets.

Statements of Revenues, Expenses and Changes in Net Assets

	2012	2011	2010
OPERATING REVENUES			
Operating revenue	$ (6,478)	$ 279,503	$ 184,674
Total operating revenues	(6,478)	279,503	184,674
OPERATING EXPENSES			
Educational and general	74,817	63,177	94,087
Grants to the University of Kentucky	4,094	6,207	7,797
Total operating expenses	78,911	69,384	101,884
NET INCOME (LOSS) FROM OPERATIONS	(85,389)	210,119	82,790
NONOPERATING REVENUES			
Additions to permanent endowments	375	400	1,000
Total nonoperating revenues	375	400	1,000
Total increase (decrease) in net assets	(85,014)	210,519	83,790
Net assets, beginning of year	1,723,923	1,513,404	1,429,614
Net assets, end of year	$ 1,638,909	$ 1,723,923	$ 1,513,404

2012. The Foundation had operating revenues of ($6,478), a decrease of $285,981 from the previous year, due to an investment loss of $12,718 in fiscal year 2012 compared to investment income of $279,353 resulting in a net change of $292,071. This was partially offset by an increase in other operating revenues of $6,090.

Operating expenses totaled $78,911, of which 94.8% was used for educational and general expenses related to instruction, and the remaining 5.2% was used to provide grants to the University for non-capital purposes.

2011 Versus 2010. Net operating income increased $127,329 when comparing fiscal year 2011 to fiscal year 2010. Total operating revenue increased $94,829 due to increased realized and unrealized gains on endowment investments offset by a decrease in other operating revenues. Total operating expenses decreased $32,500 primarily in education and general expenses.

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.

	2012	2011	2010
CASH PROVIDED (USED) BY:			
Operating activities	$ (74,249)	$ (69,167)	$ (99,310)
Noncapital financing activities	375	400	1,000
Investing activities	80,970	79,058	75,607
Net increase (decrease) in cash and cash equivalents	7,096	10,291	(22,703)
Cash and cash equivalents, beginning of year	57,723	47,432	70,135
Cash and cash equivalents, end of year	$ 64,819	$ 57,723	$ 47,432

2012. Cash payments for operating activities were primarily reimbursements to the University for salaries and benefits totaling $47,559 and payments to vendors and contractors for goods and services of $28,836. Cash provided by private gifts totaled $6,240.

Cash receipts in the noncapital financing activities group relate to private gifts to the permanent endowment of $375.

Cash provided by investing activities includes $721,456 from the sale of investments and interest and dividend income of $27,124, net of $667,610 expended on the purchase of investments.

2011 Versus 2010. In fiscal year 2011 cash increased $10,291 compared to a decrease of $22,703 in 2010. The increase in cash flows was primarily related to a decrease in cash used by operating 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, 2012.

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 MINING ENGINEERING FOUNDATION, INC.
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF NET ASSETS
JUNE 30, 2012 AND 2011

	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents	$ 14,819	$ 15,909
Total current assets	14,819	15,909
Noncurrent Assets		
Restricted cash and cash equivalents	50,000	41,814
Endowment investments	1,574,238	1,667,926
Total noncurrent assets	1,624,238	1,709,740
Total assets	1,639,057	1,725,649
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	148	1,726
Total current liabilities	148	1,726
Total liabilities	148	1,726
NET ASSETS		
Restricted		
Nonexpendable	650,226	649,851
Expendable	988,683	1,074,072
Total restricted	1,638,909	1,723,923
Total net assets	$ 1,638,909	$ 1,723,923

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 ASSETS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011
OPERATING REVENUES		
Gifts	$ 6,240	$ 150
Investment income (loss)	(12,718)	279,353
Total operating revenues	(6,478)	279,503
OPERATING EXPENSES		
Educational and general:		
Instruction	74,817	63,177
Total educational and general	74,817	63,177
Grants to (from) the University of Kentucky for non-capital purposes	4,094	6,207
Total operating expenses	78,911	69,384
Net income (loss) from operations	(85,389)	210,119
NONOPERATING REVENUES (EXPENSES)		
Additions to permanent endowments	375	400
Total other nonoperating revenues (expenses)	375	400
Increase (decrease) in net assets	(85,014)	210,519
NET ASSETS, beginning of year	1,723,923	1,513,404
NET ASSETS, end of year	$ 1,638,909	$ 1,723,923

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, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Private gifts	$ 6,240	$ 150
Payments to vendors and contractors	(28,836)	(16,353)
Salaries, wages and benefits reimbursements to the University of Kentucky	(47,559)	(46,757)
Grants (to) from the University of Kentucky for non-capital purposes	(4,094)	(6,207)
Net cash provided (used) by operating activities	(74,249)	(69,167)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes	375	400
Net cash provided (used) by noncapital financing activities	375	400
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	721,456	1,486,430
Interest and dividends on investments	27,124	29,284
Purchase of investments	(667,610)	(1,436,656)
Net cash provided (used) by investing activities	80,970	79,058
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,096	10,291
CASH AND CASH EQUIVALENTS, beginning of year	57,723	47,432
CASH AND CASH EQUIVALENTS, end of year	$ 64,819	$ 57,723

Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	$ (85,389)	$ 210,119
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Investment (income) loss	12,718	(279,353)
Change in assets and liabilities:		
Accounts payable and accrued liabilities	(1,578)	67
Net cash provided (used) by operating activities	$ (74,249)	$ (69,167)

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

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 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 assets categories:

- Invested in capital assets, net of related debt: 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 assets subject to externally imposed stipulations that they be maintained permanently by the Foundation. Such assets include the Foundation's permanent endowment funds.

  Expendable – Net assets 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 assets whose use by the Foundation is not subject to externally imposed stipulations. Unrestricted net assets 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, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

During the year ended June 30, 2012, the Foundation adopted Statement of Governmental Accounting Standards Board (GASB) No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that statement for business-type activities to apply post-November 30, 1989, FASB statements and interpretations that do not conflict with or contradict GASB pronouncements. GASB No. 62 has been applied retrospectively and had no impact on the Foundation's net assets, changes in net assets or financial reporting disclosures.

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. The Foundation's endowment investments are administered as part of the University's pooled endowment 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 Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), as adopted by the Commonwealth of Kentucky, 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 utilizes a spending policy designed to smooth spending distributions and protect endowed programs from market volatility by calculating distributions based on a percentage of the average market value of the endowment over a specified period of time. The University has made expenditure decisions in accordance with prevailing UPMIFA statute and donor gift agreements. UPMIFA allows institutions to appropriate for expenditure so much of an endowment fund as the institution deems is prudent based on a review of various factors set forth in the Act, subject to terms set forth in a gift agreement.

For the year ended June 30, 2012, the University's endowment spending rule provided for annual distributions of 4.25 percent of the sixty month moving average market value of fund units. For the year ended June 30, 2011, the University's endowment spending rule provided for annual distributions of 4.375 percent of the thirty-six month moving average market value of fund units. The amount available for spending in accordance with the University's endowment spending policy was $41,941 and $44,382 for the years ended June 30, 2012 and 2011, respectively. Additionally, for the year ended June 30, 2012, the University assessed eligible endowment accounts with a management fee of 0.25 percent of total asset value. For the year ended June 30, 2011, the University assessed eligible endowment accounts with a management fee of 0.375 percent of total asset value.

The Investment Committee of the University's Board of Trustees has approved a spending rate distribution of 4.25 percent of a sixty month moving average market value of fund units for the year ended June 30, 2013. Additionally, the Investment Committee has approved a management fee of 0.25 percent for the year ended June 30, 2013.

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 Assets.

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 Assets, 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, 2012 and 2011 is as follows:

	2012	2011
Cash on deposit with the University of Kentucky	$ 64,819	$ 57,723
Investment in University of Kentucky pooled endowment fund	1,574,238	1,667,926
Total	$ 1,639,057	$ 1,725,649

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%). At June 30, 2011, the University's pooled endowment fund consisted of common and preferred stock (4.3%), pooled equity funds (38.0%), pooled private equity funds (4.7%), pooled absolute return funds (19.1%), pooled real return funds (10.4%), pooled real estate funds (5.5%), U.S. treasury fixed income (0.8%), government agency fixed income funds (1.8%), corporate fixed income funds (2.2%), pooled fixed income funds (13.1%) and cash and cash equivalents (0.1%).

Deposit and investment policies. The Foundation follows the deposit and investment policies established by the University of Kentucky'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 of Kentucky, which the University invests in deposits and repurchase agreements with banks and the Commonwealth of Kentucky, 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 approved by the Investment Committee of the University's Board of Trustees.

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 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 statement of net assets.

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 of Kentucky 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. On November 9, 2010, the FDIC Board of Directors issued a final rule to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that provides temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts at all FDIC-insured depository institutions (the "Dodd-Frank Provision"). The separate coverage for noninterest-bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012. The Foundation's deposits are non-interest bearing and are fully insured by FDIC coverage. 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 of Kentucky (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 of Kentucky 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 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 (5%) of total investments excluding sovereign debt of governments belonging to the Organization for Economic Cooperation and Development and U.S. agencies.

At June 30, 2012, the Foundation had no underlying investments in any one issuer which represent more than five percent (5%) 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 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. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2012 and 2011 are as follows:

	2012	2011
Payable to vendors and contractors	$ 148	$ 1,726

4. INVESTMENT INCOME (LOSS)

Components of investment income (loss) for the years ended June 30, 2012 and 2011 are as follows:

	2012	2011
Interest and dividends earned on endowment investments	$ 27,106	$ 29,227
Realized and unrealized gains and losses on endowment investments	(39,842)	250,069
Interest on cash and non-endowment investments	18	57
Total	$ (12,718)	$ 279,353

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 2011 to 2012. Settlements have not exceeded insurance coverage during the past three years.

6. TRANSACTIONS WITH THE UNIVERSITY OF KENTUCKY

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

7. RECLASSIFICATIONS

Certain reclassifications to fiscal year 2011 comparative amounts have been made to conform to the fiscal year 2012 financial statement classifications. Certain transactions previously reported as an investment in stock are now being reported as an investment in pooled equity. Such classifications had no effect on the change in net assets.

8. CURRENT ECONOMIC CONDITIONS

The current economic situation continues to present not-for-profit organizations with difficult circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments. The Foundation is primarily funded by the income return from its investment in the University‘s pool of endowment funds. A negative investment return could have an adverse impact on the Foundation’s future operating results. The financial statements have been prepared using values and information currently available to the Foundation.

UNIVERSITY OF KENTUCKY®

The University of Kentucky is committed to a policy of providing opportunities to people regardless of economic or social status and will not discriminate on the basis of race, color, ethnic origin, creed, religion, political belief, sex, sexual orientation, marital status, age veteran status, or physical or mental disability.

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