

UK[®]

UNIVERSITY OF
KENTUCKY[®]



2011

**The Fund for Advancement of
Education and Research in
the University of Kentucky
Financial Statements**



**The Fund for Advancement of
Education and Research in the
University of Kentucky Medical Center
A Component Unit of the University of Kentucky**

CONTENTS	PAGE
Independent Accountants' Report	1
Management's Discussion and Analysis	2
Financial Statements	
Statements of Net Assets	7
Statements of Revenues, Expenses and Changes in Net Assets	8
Statements of Cash Flows	9
Notes to Financial Statements	10
Board of Directors	

Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors
The Fund for Advancement of
Education and Research in the
University of Kentucky Medical Center
Lexington, Kentucky

We have audited the accompanying basic financial statements of The Fund for Advancement of Education and Research in the University of Kentucky Medical Center (Fund), 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, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Fund'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 basic financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2011 and 2010, 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.

The accompanying management's discussion and analysis, as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the supplementary information and express no opinion on it.

BKD, LLP

September 29, 2011

Management's Discussion and Analysis

The Fund for Advancement of Education and Research in the University of Kentucky Medical Center's (The Fund) Management's Discussion and Analysis (MD&A) of its financial condition provides an overview of the financial performance of The Fund for the years ended June 30, 2011 and 2010. Management has prepared this discussion, which provides summary financial information, along with the financial statements and related footnotes. MD&A should be read in conjunction with the accompanying financial statements.

Financial Highlights

- Total assets increased \$163,000 or 1.2%, primarily due to increases in cash and cash equivalents and accounts receivable.
- Total liabilities increased \$188,000 or 15.9%, primarily due to an increase in due to the University of Kentucky and accounts payable.
- Operating revenues increased \$3.7 million or 24.9% to \$18.7 million, largely due to increases in nongovernmental grants and contracts of \$1.9 million and state and local of \$1.0 million.
- Operating expenses increased \$1.0 million or 15.7% to \$7.6 million.
- Net assets represented 89.7% 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 Fund's finances is whether The Fund is better off as a result of the year's activities. One key to answering this question is the financial statements of The Fund. 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 Fund in a format similar to that used by corporations, and present a long-term view of The Fund's finances. The Fund's net assets (the difference between assets and liabilities) are one sign of The Fund's financial health. Over time, increases or decreases in net assets indicate the improvement or erosion of The Fund's financial health, when considered in conjunction with non-financial facts.

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 nonoperating. GASB 35 requires gifts and endowment and investment income to be classified as nonoperating revenues

Another important factor to consider when evaluating financial viability is The Fund'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 Fund is a not-for-profit Kentucky corporation established to promote, advance and support the educational, research, charitable and other purposes of the University of Kentucky Medical Center. The Fund is considered to be an affiliate and component unit of the University of Kentucky (the University) because all Board members are related to the University as faculty, staff or trustees and/or are appointed by the Board of Trustees of the University, and certain officers of The Fund are officers of the University.

Condensed Financial Information

Statements of Net Assets

	2011	2010	2009
ASSETS			
Current assets	\$ 13,038,588	\$ 12,903,317	\$ 15,160,347
Noncurrent assets	207,841	180,444	173,501
Total assets	<u>13,246,429</u>	<u>13,083,761</u>	<u>15,333,848</u>
LIABILITIES			
Current liabilities	1,367,934	1,180,038	1,510,915
Total liabilities	<u>1,367,934</u>	<u>1,180,038</u>	<u>1,510,915</u>
NET ASSETS			
Restricted			
Nonexpendable	30,642	30,642	30,642
Expendable	621,101	652,434	826,797
Unrestricted	11,226,752	11,220,647	12,965,494
Total net assets	<u>\$ 11,878,495</u>	<u>\$ 11,903,723</u>	<u>\$ 13,822,933</u>

Assets. As of June 30, 2011, The Fund's assets totaled \$13.2 million. Cash and cash equivalents, totaling \$10.7 million or 81.1% of total assets, represented The Fund's most significant asset. Accounts receivable (primarily for dental services), net of allowances, totaled \$2.3 million or 17.4% of total assets and was The Fund's second largest asset.

Total assets increased \$163,000 during the year ended June 30, 2011, a result of increases in cash and cash equivalents of \$76,000, accounts receivable, net of allowances, of \$59,000, and endowment investments of \$29,000.

Liabilities. At June 30, 2011, The Fund's liabilities totaled \$1.4 million. Amounts due to the University for faculty salary supplements of \$771,000 represent 55.1% of total liabilities. Accounts payable and accrued liabilities of \$536,000 and deferred revenue of \$62,000 comprised the remainder of The Fund's liabilities.

Total liabilities increased \$188,000 or 15.9% during the year ended June 30, 2011. This increase was primarily in due to the University for faculty salary supplements.

Net Assets. Net assets at June 30, 2011, totaled \$11.9 million, or 89.7% of total assets. Restricted net assets totaled \$652,000 or 5.5% of total net assets and unrestricted net assets accounted for \$11.2 million or 94.5% of total net assets.

2010 Versus 2009. During the year ended June 30, 2010:

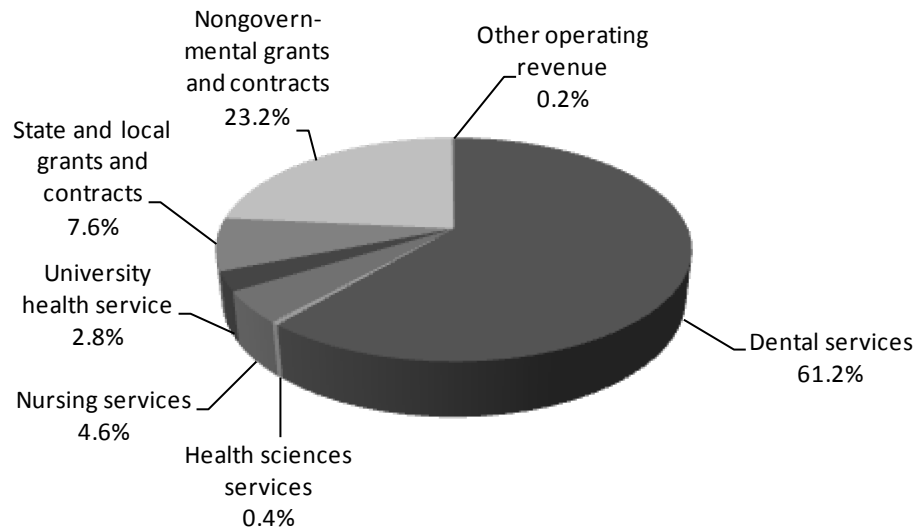
- Total assets decreased \$2.2 million or 14.7%. This decrease was driven by decreases in cash and cash equivalents and accounts receivable.
- Total liabilities decreased \$331,000 or 21.9%, due primarily to an decrease in accounts payable and accrued liabilities due to timing of payments to vendors and patient refunds.
- Total net assets decreased \$1.9 million or 13.9% primarily in unrestricted net assets due to operating expenses and grants to the University of Kentucky in excess of revenues.

Statements of Revenues, Expenses and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
OPERATING REVENUES			
Professional service fees, net of allowances			
Dental services	\$11,443,697	\$10,404,033	\$ 9,589,649
Health sciences services	81,374	45,495	37,138
Nursing services	856,961	790,178	904,085
Pharmacy	-	231,461	556,023
University health service	523,661	579,499	515,638
Total professional service fees	<u>12,905,693</u>	<u>12,050,666</u>	<u>11,602,533</u>
State and local grants and contracts	1,420,919	409,875	205,058
Nongovernmental grants and contracts	4,343,172	2,418,368	2,366,205
Other operating revenue	36,977	103,214	7,838
Total operating revenues	<u>18,706,761</u>	<u>14,982,123</u>	<u>14,181,634</u>
OPERATING EXPENSES			
Educational and general	<u>7,616,483</u>	<u>6,581,334</u>	<u>6,231,616</u>
Total operating expenses	<u>7,616,483</u>	<u>6,581,334</u>	<u>6,231,616</u>
NET INCOME FROM OPERATIONS	<u>11,090,278</u>	<u>8,400,789</u>	<u>7,950,018</u>
NONOPERATING REVENUES (EXPENSES)			
Gifts and grants	325,452	759,634	231,373
Investment income	44,892	44,897	70,678
Grants to the University of Kentucky	<u>(11,485,850)</u>	<u>(11,124,530)</u>	<u>(9,557,867)</u>
Total nonoperating revenues (expenses)	<u>(11,115,506)</u>	<u>(10,319,999)</u>	<u>(9,255,816)</u>
Total increase (decrease) in net assets	(25,228)	(1,919,210)	(1,305,798)
Net assets, beginning of year	<u>11,903,723</u>	<u>13,822,933</u>	<u>15,128,731</u>
Net assets, end of year	<u>\$11,878,495</u>	<u>\$11,903,723</u>	<u>\$13,822,933</u>

2011. Total operating revenues were \$18.7 million for the year ended June 30, 2011. The most significant source of operating revenues for The Fund was professional service fees, primarily dental, of \$12.9 million or 69.0% of the total. Operating revenues increased \$3.7 million or 24.9%, due principally to an increase in nongovernmental grants and contracts of \$1.9 million and dental professional service fees of \$1.0 million, a result of an increase in patient services.

TOTAL OPERATING REVENUES



Operating expenses totaled \$7.6 million. This entire amount was used for educational and general expenses related to functions such as student financial aid, academic support, public service and student services. Operating expenses increased \$1.0 million or 15.7% primarily in College of Medicine due to increases in student financial aid.

2010 Versus 2009. During the year ended June 30, 2010:

- Total operating revenues were \$15.0 million. The most significant source of operating revenues for The Fund was professional service fees, primarily dental service fees, of \$12.1 million or 80.7% of total operating revenues. Operating revenues increased \$800,000 or 5.6% due primarily to an increase in dental professional service fees of \$814,000 resulting from an increase in patient services and the expansion of services in Western Kentucky.
- Operating expenses totaled \$6.6 million. This entire amount was used for educational and general expenses related to functions such as academic support, instruction, hospitals and clinics, institutional support and public service. Operating expenses increased \$350,000 or 5.6% primarily in dentistry due to the addition of dental services in Western Kentucky.

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 Fund during the period. The Statement of Cash Flows also helps financial statement readers assess The Fund's:

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
CASH PROVIDED (USED) BY:			
Operating activities	\$ 11,083,089	\$ 8,949,239	\$ 8,560,866
Noncapital financing activities	(10,743,808)	(9,772,214)	(8,914,712)
Capital and related financing activities	(278,869)	(693,261)	(438,611)
Investing activities	16,056	36,691	121,836
	<u>76,468</u>	<u>(1,479,545)</u>	<u>(670,621)</u>
Cash and cash equivalents, beginning of year	<u>10,664,992</u>	<u>12,144,537</u>	<u>12,815,158</u>
Cash and cash equivalents, end of year	<u>\$ 10,741,460</u>	<u>\$ 10,664,992</u>	<u>\$ 12,144,537</u>

2011. The major source of funds included in operating activities was professional service fees of \$12.9 million. The largest cash payments for operating activities were made to suppliers of \$5.2 million.

Cash used in the noncapital financing activities group consisted of \$11.1 million in grants to the University of Kentucky offset by receipt of private gifts and grants of \$328,000.

Cash used by capital and related financing activities was related to grants of capital assets to the University.

Cash provided by investing activities included \$179,000 from the sale of investments and interest and dividend income of \$16,000, net of \$179,000 expended on the purchase of investments.

2010 Versus 2009. From June 30, 2009 to June 30, 2010 cash decreased \$1.5 million primarily due to a decrease in cash provided by noncapital and capital financing and related financing activities offset by an increase in cash provided by operating activities.

Capital Asset and Debt Administration

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

Debt. The Fund had no debt at or during the year ended June 30, 2011.

Factors Impacting Future Periods

Dentistry's trend of increasing patient services is expected to continue in fiscal year 2012 due to continued outreach in Western Kentucky and increased number of patient visits in other locations. However, this anticipated growth in revenue could be adversely affected by a worsening of the economy.

THE FUND FOR ADVANCEMENT OF EDUCATION AND RESEARCH
 IN THE UNIVERSITY OF KENTUCKY MEDICAL CENTER
 A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
 STATEMENTS OF NET ASSETS
 JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 10,741,460	\$ 10,664,992
Accounts receivable, net	2,297,128	2,238,325
Total current assets	<u>13,038,588</u>	<u>12,903,317</u>
Noncurrent Assets		
Endowment investments	207,841	179,005
Accounts receivable, net	-	1,439
Total noncurrent assets	<u>207,841</u>	<u>180,444</u>
Total assets	<u>13,246,429</u>	<u>13,083,761</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	535,549	453,245
Deferred revenue	61,580	90,828
Due to the University of Kentucky	770,805	635,965
Total current liabilities	<u>1,367,934</u>	<u>1,180,038</u>
Total liabilities	<u>1,367,934</u>	<u>1,180,038</u>
NET ASSETS		
Restricted		
Nonexpendable	30,642	30,642
Expendable	621,101	652,434
Total restricted	<u>651,743</u>	<u>683,076</u>
Unrestricted		
Total net assets	<u>\$ 11,878,495</u>	<u>\$ 11,903,723</u>

See notes to financial statements.

**THE FUND FOR ADVANCEMENT OF EDUCATION AND RESEARCH
 IN THE UNIVERSITY OF KENTUCKY MEDICAL CENTER
 A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
 FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
OPERATING REVENUE		
Professional service fees, net of allowances:		
Dental services	\$ 11,443,697	\$ 10,404,033
Health sciences services	81,374	45,495
Nursing services	856,961	790,178
Pharmacy	-	231,461
University health service	<u>523,661</u>	<u>579,499</u>
Total professional service fees	12,905,693	12,050,666
State and local grants and contracts	1,420,919	409,875
Nongovernmental grants and contracts	4,343,172	2,418,368
Other operating revenues	<u>36,977</u>	<u>103,214</u>
Total operating revenues	<u>18,706,761</u>	<u>14,982,123</u>
 OPERATING EXPENSES		
Educational and general:		
Instruction	503,922	501,337
Research	275,153	430,625
Public service	1,095,895	987,645
Libraries	3,521	3,489
Academic support	3,715,240	3,024,281
Student services	152,592	68,897
Institutional support	291,165	879,152
Student financial aid	1,529,207	611,993
Hospital and clinics	<u>49,788</u>	<u>73,915</u>
Total operating expenses	<u>7,616,483</u>	<u>6,581,334</u>
Net income from operations	<u>11,090,278</u>	<u>8,400,789</u>
 NONOPERATING REVENUES (EXPENSES)		
Gifts and grants	325,452	759,634
Investment income	44,892	44,897
Grants to the University of Kentucky for non-capital purposes	<u>(11,206,981)</u>	<u>(10,431,269)</u>
Net nonoperating revenues (expenses)	<u>(10,836,637)</u>	<u>(9,626,738)</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>253,641</u>	<u>(1,225,949)</u>
Grants to the University of Kentucky for capital purposes	<u>(278,869)</u>	<u>(693,261)</u>
Total other revenues (expenses)	<u>(278,869)</u>	<u>(693,261)</u>
Increase (decrease) in net assets	(25,228)	(1,919,210)
 NET ASSETS, beginning of year	<u>11,903,723</u>	<u>13,822,933</u>
 NET ASSETS, end of year	<u>\$ 11,878,495</u>	<u>\$ 11,903,723</u>

See notes to financial statements.

**THE FUND FOR ADVANCEMENT OF EDUCATION AND RESEARCH
 IN THE UNIVERSITY OF KENTUCKY MEDICAL CENTER
 A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
 STATEMENTS OF CASH FLOWS
 FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Professional service fees	\$ 12,897,751	\$ 12,743,522
Payments to vendors and contractors	(5,207,066)	(5,676,898)
Student financial aid	(1,529,207)	(611,993)
Salary, wage and benefit reimbursements to the University of Kentucky	(763,451)	(468,135)
Grants and contracts	5,648,085	2,859,529
Other receipts (payments)	36,977	103,214
Net cash provided (used) by operating activities	<u>11,083,089</u>	<u>8,949,239</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts and grants received for other than capital purposes	328,333	760,939
Grants (to) from the University of Kentucky	(11,072,141)	(10,533,153)
Net cash provided (used) by noncapital financing activities	<u>(10,743,808)</u>	<u>(9,772,214)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	(278,869)	(693,261)
Net cash provided (used) by capital and related financing activities	<u>(278,869)</u>	<u>(693,261)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	179,021	256,915
Interest and dividends on investments	16,057	27,880
Purchase of investments	(179,022)	(248,104)
Net cash provided (used) by investing activities	<u>16,056</u>	<u>36,691</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	76,468	(1,479,545)
CASH AND CASH EQUIVALENTS, beginning of year	<u>10,664,992</u>	<u>12,144,537</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 10,741,460</u>	<u>\$ 10,664,992</u>
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	\$ 11,090,278	\$ 8,400,789
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Change in assets and liabilities:		
Accounts receivable, net	(60,245)	777,443
Accounts payable and accrued liabilities	82,304	(319,821)
Deferred revenue	(29,248)	90,828
Net cash provided (used) by operating activities	<u>\$ 11,083,089</u>	<u>\$ 8,949,239</u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Fund for Advancement of Education and Research in the University of Kentucky Medical Center (The Fund) is a not-for-profit Kentucky corporation established to promote, advance and support the educational, research, charitable and other purposes of the University of Kentucky Medical Center (Medical Center). The Fund is considered to be an affiliate and component unit of the University of Kentucky (the University) because all Board members are related to the University as faculty, staff or trustees and/or are appointed by the Board of Trustees of the University, and certain officers of The Fund are officers of the University.

The Fund's mission is carried out through various means, including the operation of clinical practice plans and fundraising for several of the University's medical center programs.

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 Fund. Such assets include the principal of The Fund's permanent endowment funds.
 - Expendable* – Net assets whose use by The Fund is subject to externally imposed stipulations that can be fulfilled by actions of The Fund pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net assets whose use by The Fund 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 required by GASB Statement No. 35 is intended to provide a comprehensive, entity-wide perspective of The Fund's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

Pursuant to GASB Statement No. 20, The Fund has elected to apply the provisions for all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989 and do not conflict with or contradict GASB pronouncements.

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. The Fund reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

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

Accounts Receivable. This classification consists of patient accounts receivable, pledges and amounts due from affiliates that are verifiable, measurable and expected to be collected. Accounts receivable are recorded net of estimated uncollectible amounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Pooled Endowment Funds. The Fund'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 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. Prior to the passage of UPMIFA, the University was subject to the Uniform Management of Institutional Funds Act ("UMIFA"), as adopted by the Commonwealth of Kentucky, which also allowed for total return management.

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 or UMIFA statutes 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. UMIFA allowed institutions to appropriate for expenditure a prudent amount of realized and unrealized gains over the historic dollar value of an endowment fund, also subject to terms set forth in a gift agreement.

For the year ended June 30, 2011 the University's endowment spending rule provided for annual distributions of 4.375 percent of the sixty month moving average market value of fund units. For the year ended June 30, 2010, the University's endowment spending rule provided for annual distributions of 4.5 percent of the thirty-six month moving average market value of fund units. Approximately \$5,100 and \$5,000 respectively, was transferred from endowment realized and unrealized gains to support current programs in accordance with the University's endowment spending rule. Additionally, 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. For the year ended June 30, 2010, the University assessed eligible endowment accounts with a management fee of 0.5 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, 2012. Additionally, the Investment Committee has approved a management fee of 0.25 percent for the year ended June 30, 2012

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.

Deferred Revenue. Deferred revenue consists of amounts received from patients in advance of services rendered. Deferred revenue is recognized in the period in which services are rendered.

Professional Service Fees. Professional service fees are reported at net realizable amounts from patients, third-party payers and others for services rendered. Services covered by Medicare are reimbursed in accordance with the applicable published fee schedules from the Centers for Medicare and Medicaid Services while services rendered to Medicaid program beneficiaries are reimbursed according to a predetermined fee schedule provided by the Cabinet for Health and Family Services Department of Medicaid Services.

The Fund also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Fund under these agreements includes prospectively determined rates per service and discounts from established charges.

Nongovernmental Grants and Contracts. The University and Kentucky Medical Services Foundation, Inc. (KMSF) (an entity with which the University's faculty in its College of Medicine has "Practice Agreements and Assignments") have an agreement whereby The Fund received three percent of clinical income collected by KMSF for the year ended June 30, 2011 to be used for academic enrichment of the College of Medicine. For the year ended June 30, 2010 The Fund received two percent of clinical income. This revenue is classified as an operating activity in nongovernmental grants and contracts due to its contractual nature.

Grants to the University of Kentucky. Grants to the University are primarily for general program support and supplemental compensation of Medical Center health professionals. Other grants consist of capital assets purchased by The Fund that are granted to the University at the time of acquisition and endowment management fees.

Income Taxes. The Fund 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 Fund's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination on 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 Fund 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 services and goods received. Nearly all of The Fund's revenues are from exchange transactions. Certain significant expenditures, such as grants to the University, are recorded as non-operating expenses, in accordance with GASB Statement No. 35.

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 bad debt allowances.

2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2011 and 2010 is as follows:

	<u>2011</u>	<u>2010</u>
Cash on deposit with the University of Kentucky	\$ 10,741,460	\$ 10,664,992
Investment in University of Kentucky pooled endowment fund	<u>207,841</u>	<u>179,005</u>
Total	<u><u>\$ 10,949,301</u></u>	<u><u>\$ 10,843,997</u></u>

At June 30, 2011, the University's pooled endowment fund consists of common and preferred stock (5.3%), pooled equity funds (37.0%), 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 equivalents (0.1%).

At June 30, 2010, the University's pooled endowment fund consists of pooled equity funds (48.2%), pooled private equity funds (3.6%), pooled absolute return funds (10.0%), pooled real return funds (7.1%), pooled real estate funds (6.9%), U.S. treasury fixed income (4.4%), government agency fixed income funds (2.0%), corporate fixed income funds (4.4%), pooled fixed income funds (12.1%) and cash equivalents (1.3%).

Deposit and investment policies. The Fund 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 Fund's balances.

For purposes of investment management, The Fund'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 Overnight and Short-Term 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 Fund'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 Fund 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 Fund will not be able to recover the value of its investment or collateral securities that are in 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 and are 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 Fund’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 Fund’s ownership interest (units) in the University’s pooled endowment fund.

Concentrations of Credit Risk. The Fund’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 (5) 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, 2011, the Foundation had no underlying investments in any one issuer which represent more than five (5) 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 fixed income managers are limited to a duration that is within +/-25% of the duration of the Barclay 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 Fund'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's 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 RECEIVABLE

Accounts receivable, all current, as of June 30, 2011 is as follows:

	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 2,487,983	\$ (731,022)	\$ 1,756,961
University health service patient accounts	78,267	-	78,267
Other receivables, primarily KMSF	461,900	-	461,900
Total	<u>\$ 3,028,150</u>	<u>\$ (731,022)</u>	<u>\$ 2,297,128</u>

Accounts receivable as of June 30, 2010 is as follows:

	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 2,506,579	\$ (733,449)	\$ 1,773,130
University health service patient accounts	214,684	-	214,684
Pledges receivable, discounted	2,881	-	2,881
Other receivables, primarily KMSF	249,069	-	249,069
Total	<u>\$ 2,973,213</u>	<u>\$ (733,449)</u>	<u>\$ 2,239,764</u>
Current portion			\$ 2,238,325
Noncurrent			1,439
Total			<u>\$ 2,239,764</u>

4. PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Payable to vendors and contractors	\$ 294,286	\$ 196,831
Credit balances on patient accounts	235,099	256,414
Due to the University of Kentucky accrued payroll	6,164	-
Total	<u>\$ 535,549</u>	<u>\$ 453,245</u>

5. DESIGNATIONS OF UNRESTRICTED NET ASSETS

The Fund's management and/or Board of Directors designates unrestricted net assets for specific purposes, as follows:

	<u>2011</u>	<u>2010</u>
Working capital needs	\$ 2,297,128	\$ 2,239,764
Budget appropriations for operating purposes for the upcoming fiscal year	3,073,800	3,399,200
Available for future operating purposes	<u>5,855,824</u>	<u>5,581,683</u>
Total	<u>\$ 11,226,752</u>	<u>\$ 11,220,647</u>

6. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Interest and dividends earned on endowment investments	\$ 3,370	\$ 4,175
Realized and unrealized gains and losses on endowment investments	28,835	17,017
Interest on cash and non-endowment investments	<u>12,687</u>	<u>23,705</u>
Total	<u>\$ 44,892</u>	<u>\$ 44,897</u>

7. RISK MANAGEMENT

The Fund 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 2010 to 2011. Settlements have not exceeded insurance coverage during the past three years.

8. TRANSACTIONS WITH THE UNIVERSITY OF KENTUCKY

All salary, wage and benefit reimbursements to the University represent charges for University employees.

9. CURRENT ECONOMIC CONDITIONS

The current protracted economic decline continues to present not-for-profit organizations with difficult circumstances and challenges, which have led to large declines in fair value of investments and donations. The rising unemployment rate has made it difficult for certain of The Fund's patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net revenues from

professional service fees, which could have an adverse impact on The Fund's future operating results. The financial statements have been prepared using values and information currently available to The Fund. Due to the volatility of capital markets subsequent to year end, changes in investment values have been significant and may continue to affect investment amounts in the statements of net assets in the near term.

BOARD OF DIRECTORS
as of June 30, 2011

Edward Britt Brockman
Henry L. Jackson
Anita Britton
Lori S. Gonzalez
Michael Karpf
Kumble Subbaswamy
Timothy S. Tracy
Sharon Turner
Jane M. Kirschling
Emery A. Wilson

OFFICERS
as of June 30, 2011

Kumble Subbaswamy, Chair
Lori Gonzalez, Secretary
Angela S. Martin, Treasurer



see blue.™



UK®
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.

The University of Kentucky is an Equal Opportunity University. Questions concerning compliance with regulations may be directed to the Equal Opportunity Office, 13 Main Building, University of Kentucky, Lexington, KY 40506-0032. (859) 257-827 or at www.uky.edu/evpfa/eo

www.uky.edu