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UNIVERSITY OF
KENTUCKY[®]

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

2008 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**

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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 year ended June 30, 2008, 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 audit. The financial statements of the Fund as of and for the year ended June 30, 2007, were audited by other accountants whose report dated November 15, 2007, expressed an unqualified opinion on those statements.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2008 financial statements referred to above present fairly, in all material respects, the financial position of the Fund, as of June 30, 2008, and the changes in its financial position and its cash flows for the year 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 information and express no opinion on it.

BKD, LLP

September 29, 2008

Management Discussion and Analysis

The Fund for Advancement of Education and Research in the University of Kentucky Medical Center's (The Fund) Management 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, 2008 and 2007. 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

- The financial statements for FY 2007-2008 report a strong financial condition at June 30, 2008. Financial operations were in accordance with the revenue expectations and the approved budget plan.
- Total assets increased approximately \$1.5 million or 10.2%, primarily due to increases in cash and cash equivalents and in accounts receivable.
- Total liabilities decreased approximately \$132,000 or 9.2%, primarily because of a decrease in accounts payable.
- The increase in total net assets of approximately \$1.7 million, or 12.3%, was nearly all in unrestricted net assets, primarily due to operating revenues in excess of expenses and grants to the University.
- Operating revenues increased approximately \$1.3 million to \$15.6 million, largely due to an increase in dental professional fees.
- Operating expenses decreased approximately \$328,000 to \$5.2 million.
- Net assets represented 92.1% 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 of the officers of The Fund are officers of the University.

Condensed Financial Information

Statements of Net Assets

	<u>2008</u>	<u>2007</u>	<u>2006</u>
ASSETS			
Current assets	\$ 16,209,161	\$ 14,662,426	\$ 12,424,010
Noncurrent assets	227,501	251,572	223,515
Total assets	<u>16,436,662</u>	<u>14,913,998</u>	<u>12,647,525</u>
LIABILITIES			
Current liabilities	1,307,931	1,440,404	821,158
Total liabilities	<u>1,307,931</u>	<u>1,440,404</u>	<u>821,158</u>
NET ASSETS			
Restricted			
Nonexpendable	30,642	30,642	30,642
Expendable	1,800,652	1,787,095	1,353,477
Unrestricted	13,297,437	11,655,857	10,442,248
Total net assets	<u>\$ 15,128,731</u>	<u>\$ 13,473,594</u>	<u>\$ 11,826,367</u>

Assets. As of June 30, 2008, The Fund's total assets amounted to approximately \$16.4 million. Cash and cash equivalents, totaling \$12.8 million or 78.0% of total assets, represented The Fund's most significant asset. Accounts receivable (primarily for dental services), net of allowances, totaled approximately \$3.4 million or 20.7% of total assets and was The Fund's next largest asset. Endowment investments and pledges receivable comprised the remaining assets of The Fund.

Total assets increased by approximately \$1.5 million or 10.2% during the year ended June 30, 2008. This increase was driven by increases in cash and cash equivalents of approximately \$1.3 million and in accounts receivable, net of allowances, of approximately \$270,000.

Liabilities. At June 30, 2008, The Fund's liabilities totaled approximately \$1.3 million. Amounts due to the University for faculty salary supplements of approximately \$769,000 represented 59.2% of total liabilities. Accounts payable and accrued liabilities totaling approximately \$539,000 comprised the remainder of The Fund's liabilities.

Total liabilities decreased by approximately \$132,000 or 9.2% during the year ended June 30, 2008. This decrease was primarily in accounts payable related to a fundraising event in 2007.

Net Assets. Net assets at June 30, 2008, totaled approximately \$15.1 million, or 92.1% of total assets. Restricted net assets totaled approximately \$1.8 million or 11.9% of total net assets. Unrestricted net assets accounted for approximately \$13.3 million or 88.1% of total net assets.

Total net assets increased by approximately \$1.7 million or 12.3% during the year ended June 30, 2008 as a result of an increase in unrestricted net assets, principally due to operating revenues in excess of expenses and grants to the University.

2007 Versus 2006. During the year ended June 30, 2007:

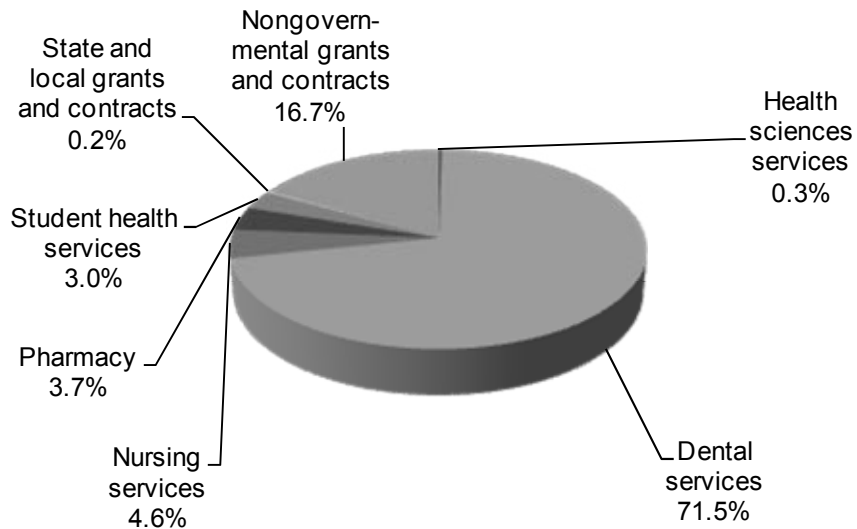
- Total assets increased by approximately \$2.3 million or 17.9%. This increase was driven by increases in cash and cash equivalents of approximately \$1.7 million and in accounts receivable, net of allowances, of approximately \$561,000.
- Total liabilities increased by approximately \$619,000 or 75.4%, due to increases in accounts payable of \$300,000 and credit balances due patients of \$239,000.
- Total net assets increased by approximately \$1.6 million or 13.9%, primarily due to an increase in unrestricted net assets of \$1.2 million caused by operating revenues in excess of expenses and an increase in restricted net assets of \$434,000 due to an increase in gifts and grants.

Statements of Revenues, Expenses and Changes in Net Assets

	<u>2008</u>	<u>2007</u>	<u>2006</u>
OPERATING REVENUES			
Professional service fees, net of allowances			
Health sciences services	\$ 42,104	\$ 40,942	\$ 50,362
Dental services	11,135,044	10,066,416	10,120,320
Nursing services	718,083	640,059	592,670
Pharmacy	583,771	655,202	453,208
Student health services	465,863	437,484	342,109
Total professional service fees	<u>12,944,865</u>	<u>11,840,103</u>	<u>11,558,669</u>
State and local grants and contracts	36,445	9,577	536,886
Nongovernmental grants and contracts	2,597,144	2,289,294	2,579,818
Other operating revenue	7,540	106,558	64,059
Total operating revenues	<u>15,585,994</u>	<u>14,245,532</u>	<u>14,739,432</u>
OPERATING EXPENSES			
Educational and general	<u>5,177,156</u>	<u>5,505,493</u>	<u>4,828,297</u>
Total operating expenses	<u>5,177,156</u>	<u>5,505,493</u>	<u>4,828,297</u>
OPERATING INCOME	<u>10,408,838</u>	<u>8,740,039</u>	<u>9,911,135</u>
NONOPERATING REVENUES (EXPENSES)			
Gifts	506,694	1,007,640	271,145
Investment income	465,996	610,501	429,092
Grants to the University of Kentucky	(9,726,391)	(8,710,953)	(8,491,826)
Total nonoperating revenues (expenses)	<u>(8,753,701)</u>	<u>(7,092,812)</u>	<u>(7,791,589)</u>
Total increase in net assets	1,655,137	1,647,227	2,119,546
Net assets, beginning of year	<u>13,473,594</u>	<u>11,826,367</u>	<u>9,706,821</u>
Net assets, end of year	<u>\$ 15,128,731</u>	<u>\$ 13,473,594</u>	<u>\$ 11,826,367</u>

Total operating revenues were approximately \$15.6 million for the year ended June 30, 2008. The most significant source of operating revenues for The Fund was professional service fees, primarily dental, of approximately \$12.9 million or 82.7% of the total. Operating revenues increased approximately \$1.3 million or 9.4%, due principally to an increase in dental professional service fees of \$1.1 million resulting from improved billing practices and increases in patient volume and fees. The remainder of the increase was primarily in nongovernmental grants and contracts.

TOTAL OPERATING REVENUES



Operating expenses totaled approximately \$5.2 million. This entire amount was used for educational and general expenses related to functions such as academic support, instruction, research, institutional support and public services. Operating expenses decreased approximately \$328,000 or 6.0% due primarily to decreases in expenses for hospital and clinics fundraising activities and for dental clinics, offset by an increase in research expenses in the Dean's Academic Enrichment Fund.

2007 Versus 2006. During the year ended June 30, 2007:

- Total operating revenues were approximately \$14.2 million. The most significant sources of operating revenues for The Fund were professional service fees of approximately \$11.8 million or 83.1%. Operating revenues decreased approximately \$494,000 or 3.4%, due to decreases in state and local grants and contracts and nongovernmental grants and contracts, partially offset by an increase in professional service fees.
- Operating expenses totaled approximately \$5.5 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 approximately \$677,000 or 14.0% due primarily to increases in expenses in the hospitals and clinics category related to fundraising activities.

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,
- The Fund's ability to meet obligations as they become due, and
- The Fund's need for external financing.

	2008	2007	2006
CASH PROVIDED (USED) BY:			
Operating activities	\$ 10,017,269	\$ 8,720,963	\$ 9,014,360
Noncapital financing activities	(8,168,028)	(7,278,941)	(7,687,022)
Capital and related financing activities	(1,062,494)	(346,622)	(557,132)
Investing activities	495,613	582,444	419,064
Net increase in cash and cash equivalents	1,282,360	1,677,844	1,189,270
Cash and cash equivalents, beginning of year	11,532,798	9,854,954	8,665,684
Cash and cash equivalents, end of year	\$ 12,815,158	\$ 11,532,798	\$ 9,854,954

The major source of funds included in operating activities was professional service fees of approximately \$12.8 million. The largest cash payments for operating activities were made to suppliers of \$4.6 million.

Cash receipts in the noncapital financing activities group consisted of private gifts and grants of approximately \$500,000 and were offset by grants to the University of Kentucky of \$8.7 million.

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

Cash provided by investing activities included approximately \$436,000 from the sale of investments and interest and dividend income of \$492,000, net of \$432,000 expended on the purchase of investments.

2007 Versus 2006. Cash increased approximately \$1.7 million primarily due to increased operating revenue from professional service fees and an increase in private gifts and grants.

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 has had no debt at or during the year ended June 30, 2008.

Factors Impacting Future Periods

To increase affordability of dental care, some fees in the student clinic will be reduced in fiscal year 2008-09. It is projected that the lower fee structure will be offset by increased patient volume and not have a significant impact on revenues.

Dentistry has purchased a Cone Beam Computed Tomography scanner and is moving forward with digital radiography. It is anticipated that these factors will contribute to increased patient services revenues as well as enhanced quality of care.

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, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 12,815,158	\$ 11,532,798
Accounts receivable, net	3,394,003	3,129,628
Total current assets	<u>16,209,161</u>	<u>14,662,426</u>
Noncurrent Assets		
Endowment investments	221,956	251,572
Accounts receivable, net	5,545	-
Total noncurrent assets	<u>227,501</u>	<u>251,572</u>
Total assets	<u>16,436,662</u>	<u>14,913,998</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	538,709	667,417
Due to University of Kentucky	769,222	772,987
Total current liabilities	<u>1,307,931</u>	<u>1,440,404</u>
Total liabilities	<u>1,307,931</u>	<u>1,440,404</u>
NET ASSETS		
Restricted		
Nonexpendable	30,642	30,642
Expendable	1,800,652	1,787,095
Total restricted	<u>1,831,294</u>	<u>1,817,737</u>
Unrestricted	<u>13,297,437</u>	<u>11,655,857</u>
Total net assets	<u>\$ 15,128,731</u>	<u>\$ 13,473,594</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, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
OPERATING REVENUE		
Professional service fees, net of allowances:		
Health sciences services	\$ 42,104	\$ 40,942
Dental services	11,135,044	10,066,416
Nursing services	718,083	640,059
Pharmacy	583,771	655,202
Student health services	<u>465,863</u>	<u>437,484</u>
Total professional service fees	12,944,865	11,840,103
State and local grants and contracts	36,445	9,577
Nongovernmental grants and contracts	2,597,144	2,289,294
Other operating revenues	<u>7,540</u>	<u>106,558</u>
Total operating revenues	<u>15,585,994</u>	<u>14,245,532</u>
OPERATING EXPENSES		
Educational and general:		
Instruction	575,280	484,832
Research	397,822	142,692
Public service	537,690	913,297
Libraries	3,503	3,479
Academic support	3,008,718	2,909,119
Student services	73,737	75,179
Institutional support	305,082	314,088
Student financial aid	193,325	105,443
Hospital and clinics	<u>81,999</u>	<u>557,364</u>
Total operating expenses	<u>5,177,156</u>	<u>5,505,493</u>
Net income (loss) from operations	<u>10,408,838</u>	<u>8,740,039</u>
NONOPERATING REVENUES (EXPENSES)		
Gifts and grants	506,694	1,007,640
Investment income	465,996	610,501
Grants to the University of Kentucky for non-capital purposes	<u>(8,663,897)</u>	<u>(8,364,331)</u>
Net nonoperating revenues (expenses)	<u>(7,691,207)</u>	<u>(6,746,190)</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>2,717,631</u>	<u>1,993,849</u>
Grants to the University of Kentucky for capital purposes	<u>(1,062,494)</u>	<u>(346,622)</u>
Total other revenues (expenses)	<u>(1,062,494)</u>	<u>(346,622)</u>
Increase in net assets	1,655,137	1,647,227
NET ASSETS, beginning of year	<u>13,473,594</u>	<u>11,826,367</u>
NET ASSETS, end of year	<u>\$ 15,128,731</u>	<u>\$ 13,473,594</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, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Professional service fees	\$ 12,801,844	\$ 11,456,727
Payments to vendors and contractors	(4,553,617)	(4,608,826)
Student financial aid	(193,325)	(105,443)
Salaries, wages and benefits	(595,228)	(490,747)
Grants and contracts	2,550,055	2,298,871
Other receipts (payments)	7,540	170,381
Net cash provided (used) by operating activities	<u>10,017,269</u>	<u>8,720,963</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts and grants received for other than capital purposes	499,634	1,005,971
Grants (to) from the University of Kentucky	<u>(8,667,662)</u>	<u>(8,284,912)</u>
Net cash provided (used) by noncapital financing activities	<u>(8,168,028)</u>	<u>(7,278,941)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	<u>(1,062,494)</u>	<u>(346,622)</u>
Net cash provided (used) by capital and related financing activities	<u>(1,062,494)</u>	<u>(346,622)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	435,666	501,756
Interest and dividends on investments	491,646	580,381
Purchase of investments	<u>(431,699)</u>	<u>(499,693)</u>
Net cash provided (used) by investing activities	<u>495,613</u>	<u>582,444</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>1,282,360</u>	<u>1,677,844</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>11,532,798</u>	<u>9,854,954</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 12,815,158</u>	<u>\$ 11,532,798</u>
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	\$ 10,408,838	\$ 8,740,039
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Change in assets and liabilities:		
Accounts receivable, net	(262,861)	(319,553)
Accounts payable and accrued liabilities	<u>(128,708)</u>	<u>300,477</u>
Net cash provided (used) by operating activities	<u>\$ 10,017,269</u>	<u>\$ 8,720,963</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. 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 of the 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 and pledges 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. The University employs the total return concept of investment management for setting investment objectives and determining investment performance. This concept recognizes dividends and interest, plus or minus realized and unrealized gains or losses, in determining the total return earned during any particular period. 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.

The Uniform Management of Institutional Funds Act (UMIFA), as adopted by the Commonwealth of Kentucky, permits the University to appropriate an amount of the realized and unrealized endowment appreciation to support current programs. Accordingly, spendable return from the endowment is determined using the total return philosophy. This philosophy recognizes a prudent amount of realized and unrealized gains as spendable return in addition to traditional yield. Distribution of investment earnings for expenditure by participating funds is supported first by traditional yield earned and, if necessary, a transfer from the endowment of any prior years' accumulated earnings (unexpended traditional yield) or net realized or unrealized gains.

The University's endowment spending rule provides for annual distributions of 4.5 percent of the three-year moving average market value of fund units. For each of the years ended June 30, 2008 and 2007 approximately \$2,800 was transferred from endowment realized and unrealized gains to support current programs in accordance with the University's endowment spending rule. Appreciation on endowments available to support future spending rule distributions amounted to approximately \$170,000 at June 30, 2008. The University assesses eligible endowment accounts with a management fee of 0.5 percent to support fundraising and endowment administration.

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.

Patient Services Revenues. Patient services revenues are reported at net realizable amounts from patients, third-party payors 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 organization 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 receives two percent of clinical income collected by KMSF to be used for academic enrichment of the College of Medicine. 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. Additionally, capital assets purchased by The Fund are granted to the University of Kentucky at the time of acquisition.

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, 2008 and 2007 is as follows:

	<u>2008</u>	<u>2007</u>
Cash on deposit with the University of Kentucky	\$ 12,815,158	\$ 11,532,798
Investment in University of Kentucky pooled endowment fund	<u>221,956</u>	<u>251,572</u>
Total	<u><u>\$ 13,037,114</u></u>	<u><u>\$ 11,784,370</u></u>

At June 30, 2008, the University's pooled endowment fund consists of pooled equity funds (66.0%), private equity funds (1.7%), pooled real estate funds (9.0%), government agency fixed income funds (5.8%), corporate fixed income funds (5.9%), pooled fixed income funds (10.8%) and cash equivalents (0.8%).

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 local 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, including credit, interest rate and foreign currency risk, as discussed in more detail below:

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. Credit risk on repurchase agreements with local banks 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 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 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 with local banks, which are held in the University's name, and deposits and repurchase agreements with the Commonwealth of Kentucky, which 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 invested in one issuer. However, all such investments 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 investment managers are limited to a maximum investment in any one issuer of no more than 5% of total investments.

At June 30, 2008, The Fund had no underlying investments in any one issuer which represent more than 5% of total investments.

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 investments held by the University's fixed income managers are limited to a duration that is within +/-25% of the duration of the Lehman Aggregate Bond Index.

Foreign Currency Risk. Foreign currency risk is the risk that changes 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 limited endowment investments of the University's pooled endowment fund, including pooled fixed income funds, a pooled global equity fund and a pooled non-U.S. equity fund. The University's endowment investment policy allows fixed-income managers to invest a portion of their funds in non-U.S. securities and equity fund managers of co-mingled portfolios to invest in accordance with the guidelines established in the individual fund's prospectus.

3. ACCOUNTS RECEIVABLE

Accounts receivable as of June 30, 2008 and 2007 are as follows:

	2008		
	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 4,304,724	\$(1,227,453)	\$ 3,077,271
University health service patient accounts	95,748	-	95,748
Pledges receivable, discounted	8,729	-	8,729
Other receivables	217,800	-	217,800
Total	<u>\$ 4,627,001</u>	<u>\$(1,227,453)</u>	<u>\$ 3,399,548</u>
Current portion			\$ 3,394,003
Noncurrent portion			5,545
Total			<u>\$ 3,399,548</u>
	2007		
	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 3,776,447	\$ (847,711)	\$ 2,928,736
University health service patient accounts	64,957	-	64,957
Pledges receivable, discounted	1,669	-	1,669
Other receivables, primarily KMSF	134,266	-	134,266
Total	<u>\$ 3,977,339</u>	<u>\$ (847,711)</u>	<u>\$ 3,129,628</u>
Current portion			<u>\$ 3,129,628</u>

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2008 and 2007 are as follows:

	2008	2007
Payable to vendors and contractors - operating	\$ 210,402	\$ 381,728
Credit balances on patient accounts	321,286	284,981
Accrued expenses for payroll	7,021	708
Total	<u>\$ 538,709</u>	<u>\$ 667,417</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>2008</u>	<u>2007</u>
Working capital needs	\$ 3,399,548	\$ 3,129,628
Budget appropriations for operating purposes for the upcoming fiscal year	3,588,800	3,241,400
Available for future operating purposes	<u>6,309,089</u>	<u>5,284,829</u>
Total	<u>\$ 13,297,437</u>	<u>\$ 11,655,857</u>

6. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Interest and dividends earned on endowment investments	\$ 6,532	\$ 5,837
Realized and unrealized gains and losses on endowment investments	(25,650)	30,120
Interest on cash and non-endowment investments	<u>485,114</u>	<u>574,544</u>
Total	<u>\$ 465,996</u>	<u>\$ 610,501</u>

7. PLEDGES AND DEFERRED GIFTS

Operating pledges totaling approximately \$13,154 are expected to be collected over the next five years. In accordance with GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions," the Fund is required to record operating pledges as revenue when all eligibility requirements have been met. Accordingly, at June 30, 2008, the Fund recorded the discounted value of operating pledges receivable using a rate of 6 percent, net of allowance for uncollectible pledges, of approximately \$8,700.

8. 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 2007 to 2008. Settlements have not exceeded insurance coverage during the past three years.

9. TRANSACTIONS WITH THE UNIVERSITY OF KENTUCKY

All salaries, wages and benefits represent charges for University employees.

10. RECLASSIFICATIONS

To conform to 2008 classifications, 2007 comparative assets and liabilities have been adjusted to report credit balances on patient receivables as a liability. Such reclassifications had no effect on the change in net assets.

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