

**The Fund for Advancement of
Education and Research in the
University of Kentucky Medical Center
2014 Financial Statements**



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**The Fund for Advancement of
Education and Research in the
University of Kentucky Medical Center
A Component Unit of the University of Kentucky
Financial Statements
Years ended June 30, 2014 and 2013**

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Independent Auditor's Report

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, which are comprised of statements of net position as of June 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the basic financial statements, as listed in the table of contents, of The Fund for Advancement of Education and Research in the University of Kentucky Medical Center (The Fund), a not-for-profit corporation affiliated with and a component unit of the University of Kentucky.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to The Fund's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of The Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Fund as of June 30, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The board of directors listing as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements and accordingly, we do not express an opinion or provide any assurance on it.

BKD, LLP

Louisville, Kentucky
October 3, 2014

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, 2014 and 2013. 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 \$1,212,068 or 12.6%, due to an increase in accounts receivable, net and offset by decreases in cash and cash equivalents and endowment investments.
- Operating revenues increased \$2,411,776 or 11.2%, largely due to increases in nongovernmental grants and contracts of \$2,444,908.
- Operating expenses increased \$3,687,799 or 37.7%, primarily due to increases in public service, instruction and academic support.
- Net position increased \$1,209,013 or 14.6%, primarily due to a \$1,111,260 increase in unrestricted net position and a \$97,753 increase in restricted expendable net position. The increases were results from revenues in excess of operating expenses and grants to the University of Kentucky. Net position represented 87.7% of total assets.

Using the Financial Statements

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

One of the most important questions asked about The 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 Position, the Statement of Revenues, Expenses and Changes in Net Position, 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 position (the difference between assets, deferred outflows of resources, liabilities and deferred inflows of resources) is one sign of The Fund's financial health. Over time, increases or decreases in net position indicate the improvement or erosion of The Fund's financial health, when considered in conjunction with non-financial facts.

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

The Statement of Revenues, Expenses and Changes in Net Position presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or 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 Statements of Net Position

	2014	2013	2012
ASSETS			
Current assets	\$ 10,706,003	\$ 9,388,672	\$ 10,359,053
Noncurrent assets	136,623	241,886	190,013
Total assets	10,842,626	9,630,558	10,549,066
LIABILITIES			
Current liabilities	1,334,028	1,330,973	1,344,279
Total liabilities	1,334,028	1,330,973	1,344,279
NET POSITION			
Restricted			
Nonexpendable	30,642	30,642	30,642
Expendable	652,545	554,792	892,445
Unrestricted	8,825,411	7,714,151	8,281,700
Total net position	\$ 9,508,598	\$ 8,299,585	\$ 9,204,787

Assets. As of June 30, 2014, The Fund's assets totaled \$10,842,626. Cash and cash equivalents, totaling \$6,312,831 or 58.2% of total assets, represented The Fund's most significant asset. Accounts receivable (primarily for dean's academic enrichment and dental services), net of allowances, totaled \$4,393,172 or 40.5% of total assets and was The Fund's second largest asset.

Total assets increased \$1,212,068 during the year ended June 30, 2014, a result of an increase in other receivable of \$2,118,297 offset by decreases in cash and cash equivalents of \$678,620, accounts receivable, net of allowances of \$122,346 and endowment investments of \$105,263.

Liabilities. At June 30, 2014, The Fund's liabilities totaled \$1,334,028. Amounts due to the University for faculty salary supplements of \$805,633 represent 60.4% of total liabilities. Accounts payable and accrued liabilities of \$450,884 and unearned revenue of \$77,511 comprised the remainder of The Fund's liabilities.

Total liabilities increased \$3,055 during the year ended June 30, 2014. This increase was primarily due to an increase in accounts payable and accrued liabilities and due to the University offset by a decrease in unearned revenue.

Net Position. Net position at June 30, 2014, totaled \$9,508,598 or 87.7% of total assets. Restricted net position totaled \$683,187 or 7.2% of total net position and unrestricted net position accounted for \$8,825,411 or 92.8% of total net position.

2013 Versus 2012. During the year ended June 30, 2013:

- Total assets decreased \$918,508. This decrease was driven primarily by a decrease in cash and cash equivalents and an increase in accounts receivable, net of allowances.
- Total liabilities decreased \$13,306 or 1.0%, due to decreases in due to the University and accounts payable and accrued liabilities offset by an increase in unearned revenue.

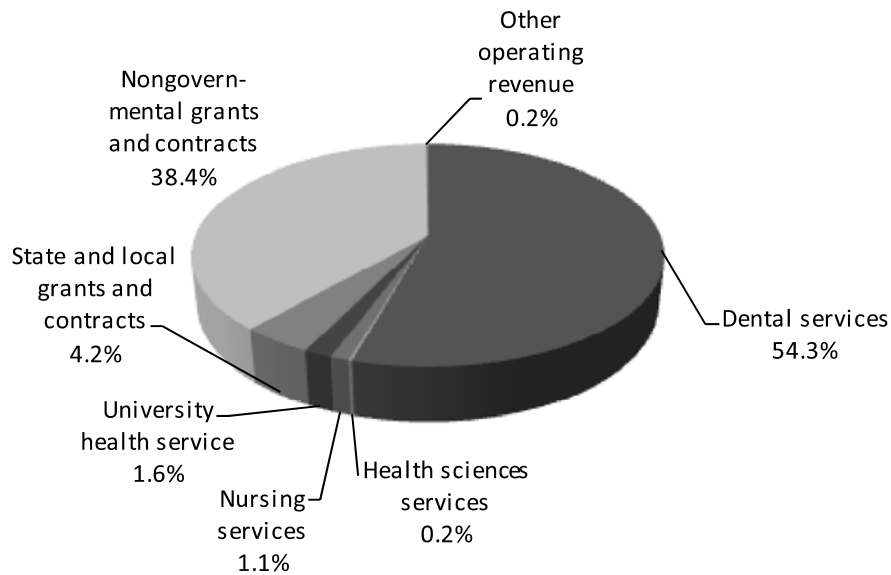
- Total net position decreased \$905,202, due to decreases in unrestricted net position and restricted expendable net position.

Condensed Statements of Revenues, Expenses and Changes in Net Position

	<u>2014</u>	<u>2013</u>	<u>2012</u>
OPERATING REVENUES			
Professional service fees, net of allowances			
Dental services	\$13,036,372	\$12,532,753	\$11,984,676
Health sciences services	49,004	99,217	97,848
Nursing services	259,308	650,130	767,122
University health service	391,726	466,786	422,330
Total professional service fees	<u>13,736,410</u>	<u>13,748,886</u>	<u>13,271,976</u>
State and local grants and contracts	999,864	981,473	690,834
Nongovernmental grants and contracts	9,193,243	6,748,335	5,256,108
Other operating revenue	44,837	83,884	41,508
Total operating revenues	<u>23,974,354</u>	<u>21,562,578</u>	<u>19,260,426</u>
OPERATING EXPENSES			
Educational and general	<u>13,472,287</u>	<u>9,784,488</u>	<u>9,036,630</u>
Total operating expenses	<u>13,472,287</u>	<u>9,784,488</u>	<u>9,036,630</u>
NET INCOME FROM OPERATIONS	<u>10,502,067</u>	<u>11,778,090</u>	<u>10,223,796</u>
NONOPERATING REVENUES (EXPENSES)			
Gifts and grants	207,585	107,184	151,400
Investment income	29,141	37,162	8,309
Grants to the University of Kentucky	<u>(9,529,780)</u>	<u>(12,827,638)</u>	<u>(13,057,213)</u>
Total nonoperating revenues (expenses)	<u>(9,293,054)</u>	<u>(12,683,292)</u>	<u>(12,897,504)</u>
Total increase (decrease) in net position	1,209,013	(905,202)	(2,673,708)
Net position, beginning of year	<u>8,299,585</u>	<u>9,204,787</u>	<u>11,878,495</u>
Net position, end of year	<u>\$ 9,508,598</u>	<u>\$ 8,299,585</u>	<u>\$ 9,204,787</u>

2014. Total operating revenues were \$23,974,354 for the year ended June 30, 2014. The most significant source of operating revenues for The Fund was professional service fees, primarily dental, of \$13,736,410 or 57.3% of the total. Operating revenues increased \$2,411,776 or 11.2%, mainly due to an increase in nongovernmental grants and contracts of \$2,444,908. The increase is primarily due to an increase in revenue from the College of Medicine to cover expenditures by the Deans Academic Enrichment account.

TOTAL OPERATING REVENUES



Operating expenses totaled \$13,472,287. This entire amount was used for educational and general expenses related to functions such as academic support, student financial aid, public service and student services. Operating expenses increased \$3,687,799 or 37.7% primarily in Dentistry due to increases in public support, instruction and academic support. Nonoperating expenses decreased \$3,390,238 primarily in grants to the University for non-capital and capital purposes.

2013 Versus 2012. During the year ended June 30, 2013:

- Total operating revenues were \$21,562,578. The most significant source of operating revenues for The Fund was professional service fees, primarily dental service fees, of \$13,748,886 or 63.8% of total operating revenues. Operating revenues increased \$2,302,152 or 12.0% due primarily to increases in nongovernmental grants and contracts of \$1,492,227 and professional service fees of \$476,910, resulting from an increase in patient services along with an increase in fees.
- Operating expenses totaled \$9,784,488. This entire amount was used for educational and general expenses related to functions such as academic support, student financial aid, public service and student services. Operating expenses increased \$747,858 or 8.3% primarily in Deans Academic Enrichment due to increases in student services and student financial aid offset with decreases in instruction, academic support and institutional support.

Condensed 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>2014</u>	<u>2013</u>	<u>2012</u>
CASH PROVIDED (USED) BY:			
Operating activities	\$ 8,482,186	\$ 11,572,636	\$ 10,271,416
Noncapital financing activities	(9,291,403)	(11,185,643)	(11,480,121)
Capital and related financing activities	(3,807)	(1,582,189)	(1,357,533)
Investing activities	<u>134,404</u>	<u>(14,711)</u>	<u>26,136</u>
Net increase (decrease) in cash and cash equivalents	(678,620)	(1,209,907)	(2,540,102)
Cash and cash equivalents, beginning of year	<u>6,991,451</u>	<u>8,201,358</u>	<u>10,741,460</u>
Cash and cash equivalents, end of year	<u><u>\$ 6,312,831</u></u>	<u><u>\$ 6,991,451</u></u>	<u><u>\$ 8,201,358</u></u>

2014. The major sources of funds included in operating activities was professional service fees of \$14,003,915 and grants and contracts of \$7,868,776. The largest cash payments for operating activities were made to suppliers of \$6,998,645.

Cash used in the noncapital financing activities group consisted of \$9,498,988 in grants to the University of Kentucky offset by receipt of private gifts and grants of \$207,585.

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

Cash provided by investing activities included \$199,916 on the sale of investments net of \$72,872 from the purchase of investments and interest and dividend income of \$7,360.

2013 Versus 2012. From June 30, 2012 to June 30, 2013 cash decreased \$1,209,907 due to increases in cash used by capital and related financing activities and investing activities offset by a decrease in cash used by noncapital financing activities and 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, 2014.

Factors Impacting Future Periods

Dentistry's trend of increasing patient services is expected to continue in fiscal year 2015 with the UK Healthcare and College of Dentistry collaboration in Lexington and continued outreach around the Commonwealth. These increases coupled with improvements with billings and collections operations should enhance revenue streams. However, this anticipated growth in revenue could be adversely affected by a worsening of the economy and reforms in federal and state regulations affecting the practice of dentistry.

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 POSITION
 JUNE 30, 2014 AND 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 6,312,831	\$ 6,991,451
Accounts receivable, net	1,937,277	2,059,623
Other receivable	2,455,895	337,598
Total current assets	<u>10,706,003</u>	<u>9,388,672</u>
Noncurrent Assets		
Endowment investments	136,623	241,886
Total noncurrent assets	<u>136,623</u>	<u>241,886</u>
Total assets	<u>10,842,626</u>	<u>9,630,558</u>
 LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	450,884	418,825
Unearned revenue	77,511	133,500
Due to the University of Kentucky	805,633	778,648
Total current liabilities	<u>1,334,028</u>	<u>1,330,973</u>
Total liabilities	<u>1,334,028</u>	<u>1,330,973</u>
 NET POSITION		
Restricted		
Nonexpendable	30,642	30,642
Expendable	652,545	554,792
Total restricted	<u>683,187</u>	<u>585,434</u>
Unrestricted	<u>8,825,411</u>	<u>7,714,151</u>
Total net position	<u>\$ 9,508,598</u>	<u>\$ 8,299,585</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 POSITION
 FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

	<u>2014</u>	<u>2013</u>
OPERATING REVENUE		
Professional service fees, net of allowances:		
Dental services	\$ 13,036,372	\$ 12,532,753
Health sciences services	49,004	99,217
Nursing services	259,308	650,130
University health service	391,726	466,786
Total professional service fees	<u>13,736,410</u>	<u>13,748,886</u>
State and local grants and contracts	999,864	981,473
Nongovernmental grants and contracts	9,193,243	6,748,335
Other operating revenues	44,837	83,884
Total operating revenues	<u>23,974,354</u>	<u>21,562,578</u>
OPERATING EXPENSES		
Educational and general:		
Instruction	981,531	314,923
Research	302,379	228,261
Public service	3,153,821	1,149,394
Libraries	-	3,477
Academic support	4,646,535	4,160,795
Student services	1,094,444	1,120,031
Institutional support	122,071	223,527
Operations and maintenance	236,835	-
Student financial aid	2,875,977	2,529,040
Hospital and clinics	58,694	55,040
Total operating expenses	<u>13,472,287</u>	<u>9,784,488</u>
Net income from operations	<u>10,502,067</u>	<u>11,778,090</u>
NONOPERATING REVENUES (EXPENSES)		
Gifts and grants	207,585	107,184
Investment income	29,141	37,162
Grants to the University of Kentucky for non-capital purposes	(9,525,973)	(11,232,511)
Net nonoperating revenues (expenses)	<u>(9,289,247)</u>	<u>(11,088,165)</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>1,212,820</u>	<u>689,925</u>
Grants to the University of Kentucky for capital purposes	(3,807)	(1,595,127)
Total other revenues (expenses)	<u>(3,807)</u>	<u>(1,595,127)</u>
Increase (decrease) in net position	1,209,013	(905,202)
NET POSITION, beginning of year	<u>8,299,585</u>	<u>9,204,787</u>
NET POSITION, end of year	<u>\$ 9,508,598</u>	<u>\$ 8,299,585</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, 2014 AND 2013**

	<u>2014</u>	<u>2013</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Professional service fees	\$ 14,003,915	\$ 13,732,149
Payments to vendors and contractors	(6,998,645)	(4,710,443)
Student financial aid	(2,875,977)	(2,529,040)
Salary, wage and benefit reimbursements to the University of Kentucky	(3,560,720)	(2,574,813)
Grants and contracts	7,868,776	7,570,899
Other receipts (payments)	44,837	83,884
Net cash provided (used) by operating activities	<u>8,482,186</u>	<u>11,572,636</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts and grants received for other than capital purposes	207,585	107,184
Grants (to) from the University of Kentucky	(9,498,988)	(11,292,827)
Net cash provided (used) by noncapital financing activities	<u>(9,291,403)</u>	<u>(11,185,643)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	(3,807)	(1,582,189)
Net cash provided (used) by capital and related financing activities	<u>(3,807)</u>	<u>(1,582,189)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	199,916	119,616
Interest and dividends on investments	7,360	15,646
Purchase of investments	(72,872)	(149,973)
Net cash provided (used) by investing activities	<u>134,404</u>	<u>(14,711)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(678,620)</u>	<u>(1,209,907)</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>6,991,451</u>	<u>8,201,358</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 6,312,831</u>	<u>\$ 6,991,451</u>
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	\$ 10,502,067	\$ 11,778,090
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Change in assets and liabilities:		
Accounts receivable, net	(1,995,951)	(239,526)
Accounts payable and accrued liabilities	32,059	(31,902)
Unearned revenue	(55,989)	65,974
Net cash provided (used) by operating activities	<u>\$ 8,482,186</u>	<u>\$ 11,572,636</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 position categories:

- Net investment in capital assets: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
 - Nonexpendable* – Net position subject to externally imposed stipulations that it be maintained permanently by The Fund. Such assets include the principal of The Fund's permanent endowment funds.
 - Expendable* – Net position 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 position whose use by The Fund is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation required by GASB Statement No. 35 is intended to provide a comprehensive, entity-wide perspective of The Fund's assets, deferred outflows of resources, liabilities, deferred inflows of resources, net position, revenues, expenses, changes in net position and cash flows.

Summary of Significant Accounting Policies

Accrual Basis. The financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. 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. All endowments are managed in a consolidated investment pool, which consists of more than 2,100 named funds. All contributing endowments participate in the income and appreciation of the pool on a per unit basis commensurate with their contribution to the pool. New endowments purchase units in the pool at the current unit value, which is calculated each month based on the fair value of the pool investments divided by the number of pool units outstanding. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

In accordance with the Kentucky Uniform Prudent Management of Institutional Funds Act (UPMIFA), as adopted by the Commonwealth in July 2010, the University employs a total return method for establishing investment objectives and spending policies designed to achieve financial equilibrium for endowment funds over the long term. The University makes expenditure decisions in accordance with UPMIFA and donor gift agreements. UPMIFA prescribes guidelines for expenditure of a donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations) and focuses on the entirety of a donor-restricted endowment fund, that is, both the original gift amount(s) and net appreciation. In accordance with the standard of prudence prescribed by UPMIFA and consistent with industry standards, the University has adopted a spending policy whose long-term objective is to maintain the purchasing power of each endowment and provide a predictable and sustainable level of income to support current operations.

The University has established a "hybrid" spending policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending will be calculated by taking a weighted average comprising 60% of the prior year's spending, adjusted for inflation, and 40% of the amount that results when the target annual spending rate of four percent is applied to the average market value of the endowment over the preceding 36 months. The spending amount determined by the formula will be constrained so that the calculated rate is at least three percent, and not more than six percent, of the current endowment market value. The hybrid spending policy will be phased in over two years with the new policy fully implemented in the year ending June 30, 2015. The year ended June 30, 2014 served as a transition year to the new policy and spending was based on four percent of the average market value for the preceding 60 months. For the year ended June 30, 2013, the University's endowment standard spending rule provided for annual distributions of 4.25% of the 60 month moving average market value of fund units.

Additionally, for the fiscal year ended June 30, 2014 spending and management fee withdrawals were suspended on all endowments with a market value less than the contributed value by more than 20% at December 31st of the prior year. Endowments with a market value less than the contributed value by more than 10% went through a formal review to determine the appropriate level of spending in accordance with various factors set forth in UPMIFA. For fiscal year 2013 reduced spending rules were also established for certain endowments whose market value was less than the contributed value as of December 31st of the prior year.

For the years ended June 30, 2014 and 2013, the University's annual endowment management fee was 0.25%, however endowments whose market value was less than the contributed value as of December 31st were exempt from the management fee in the subsequent fiscal year.

The amount of gross spending policy distribution in accordance with the University's endowment spending policy was \$29,197 and \$8,987 for the years ended June 30, 2014 and 2013, respectively.

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 Position.

Unearned Revenue. Unearned revenue consists of amounts received from patients in advance of services 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 receives clinical income only on a need basis for year ended June 30, 2014 compared to four percent of clinical income collected by KMSF for year ended June 30, 2013 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. 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 Position, 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, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Cash on deposit with the University of Kentucky	\$ 6,312,831	\$ 6,991,451
Investment in University of Kentucky pooled endowment fund	<u>136,623</u>	<u>241,886</u>
Total	<u>\$ 6,449,454</u>	<u>\$ 7,233,337</u>

At June 30, 2014, the University's pooled endowment fund consisted of cash and cash equivalents (0.4%), common and preferred stock (4.6%), corporate fixed income funds (0.5%), government agency fixed income funds (0.2%), pooled absolute return funds (11.6%), pooled equity funds (28.3%), pooled fixed income funds (7.5%), pooled global tactical asset allocation funds (7.6%), pooled long/short equity funds (12.1%), pooled private equity funds (9.9%), pooled real estate funds (6.7%), pooled real return funds (9.6%), and U.S. Treasury fixed income (1.0%).

At June 30, 2013, the University's pooled endowment fund consisted of cash and cash equivalents (0.8%), common and preferred stock (4.3%), corporate fixed income funds (2.3%), government agency fixed income funds (0.9%), pooled absolute return funds (20.2%), pooled equity funds (37.9%), pooled fixed income funds (9.3%), pooled private equity funds (8.3%), pooled real estate funds (6.7%), pooled real return funds (8.5%), and U.S. Treasury fixed income (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, which the University invests in deposits and repurchase agreements with banks and the Commonwealth of Kentucky (the Commonwealth), 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 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 Statements of Net Position.

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing The 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 is governed by policy that minimizes risk in several ways. Deposits are governed by state law which requires full collateralization for balances exceeding

amounts covered by the Federal Deposit Insurance Corporation (FDIC). The Fund's deposits are insured up to \$250,000 at each FDIC insured institution.

- 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 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.

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 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 deposit insurance are required to be fully collateralized by U.S. Treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- The University's endowment fixed income managers are limited to a maximum investment in any one issuer of no more than five percent of total investments excluding sovereign debt of governments belonging to the Organization for Economic Cooperation and Development and U.S. agencies.

At June 30, 2014, the Fund had no underlying investments in any one issuer which represent more than five percent of total investments other than U.S. Treasury and agency obligations.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Cash on deposit with the University has limited exposure to interest rate risk due to the short term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Endowment managers are permitted to use derivative instruments to limit interest rate risk. Additionally, endowment investments held by the University's core plus fixed income managers are limited to a duration that is within two years of the duration of the Barclay Aggregate Bond Index and new unconstrained fixed income strategies have been implemented to further protect against rising interest rates.

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. Endowment managers are permitted to use derivative instruments to limit foreign currency risk.

3. ACCOUNTS AND OTHER RECEIVABLES

Accounts receivable, all current, as of June 30, 2014 is as follows:

	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 2,583,813	\$ (690,457)	\$ 1,893,356
University health service patient accounts	43,921	-	43,921
KMSF receivable	2,424,331	-	2,424,331
Other receivables	<u>31,564</u>	<u>-</u>	<u>31,564</u>
Total	<u>\$ 5,083,629</u>	<u>\$ (690,457)</u>	<u>\$ 4,393,172</u>

Accounts receivable, all current, as of June 30, 2013 is as follows:

	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 2,773,388	\$ (796,845)	\$ 1,976,543
University health service patient accounts	83,080	-	83,080
KMSF receivable	100,000	-	100,000
Other receivables	<u>237,598</u>	<u>-</u>	<u>237,598</u>
Total	<u>\$ 3,194,066</u>	<u>\$ (796,845)</u>	<u>\$ 2,397,221</u>

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Payable to vendors and contractors	\$ 164,213	\$ 172,812
Credit balances on patient accounts	262,404	222,766
Due to the University of Kentucky for accrued payroll	<u>24,267</u>	<u>23,247</u>
Total	<u>\$ 450,884</u>	<u>\$ 418,825</u>

5. DESIGNATIONS OF UNRESTRICTED NET POSITION

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

	<u>2014</u>	<u>2013</u>
Working capital needs	\$ 4,393,172	\$ 2,397,221
Budget appropriations for operating purposes for the upcoming fiscal year	1,955,200	2,017,900
Available for future operating purposes	<u>2,477,039</u>	<u>3,299,030</u>
Total	<u>\$ 8,825,411</u>	<u>\$ 7,714,151</u>

6. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Interest and dividends earned on endowment investments	\$ 2,370	\$ 3,975
Realized and unrealized gains and losses on endowment investments	21,781	21,516
Interest on cash and non-endowment investments	<u>4,990</u>	<u>11,671</u>
Total	<u>\$ 29,141</u>	<u>\$ 37,162</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 2013 to 2014. Settlements have not exceeded insurance coverage during the past three years.

8. TRANSACTIONS WITH RELATED PARTIES

Grants to the University are primarily for general program support, supplemental compensation on Medical Center Health professionals and for the Endowment management fees. All salary, wage and benefit reimbursements to the University represent charges for University employees.

Nongovernmental grants and contracts are generated primarily from clinical revenue in the College of Medicine. The College of Medicine allocates a portion of clinical revenue to the Dean's Academic Enrichment for approved academic enrichment activities.

9. RECLASSIFICATION

Certain reclassifications to fiscal 2013 comparative amounts have been made to conform to the fiscal year 2014 financial statement classifications. Such classifications had no effect on the change in net position.

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