

UNIVERSITY OF KENTUCKY®



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

2015 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
Financial Statements
Years ended June 30, 2015 and 2014**

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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, 2015 and 2014, 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Fund as of June 30, 2015 and 2014, 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 2, 2015

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, 2015 and 2014. 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 \$2,228,513 or 20.6%, due to increases in cash and cash equivalents, accounts receivable, net and endowment investments offset by a decrease in other receivables.
- Total liabilities increased \$349,260 or 26.2%, due to increases in accounts payable and accrued liabilities, due to the University and unearned revenue.
- Net position increased \$1,879,253 or 19.8%, due to a \$1,897,208 increase in unrestricted net position offset by \$17,955 decrease in restricted expendable net position. The increase results from revenues in excess of operating expenses and grants to the University of Kentucky. Net position represented 87.1% of total assets.
- Operating revenues decreased \$1,499,301 or 6.3%, primarily due to a decrease in nongovernmental grants and contracts of \$2,882,434 offset by an increase in state and local grants and contracts of \$954,630 and an increase in dental services of \$594,310.
- Operating expenses decreased \$2,022,251 or 15.0%, primarily due to decreases in student financial aid and academic support.

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

	2015	2014	2013
ASSETS			
Current assets	\$ 12,905,867	\$ 10,706,003	\$ 9,388,672
Noncurrent assets	165,272	136,623	241,886
Total assets	13,071,139	10,842,626	9,630,558
LIABILITIES			
Current liabilities	1,683,288	1,334,028	1,330,973
Total liabilities	1,683,288	1,334,028	1,330,973
NET POSITION			
Restricted			
Nonexpendable	30,642	30,642	30,642
Expendable	634,590	652,545	554,792
Unrestricted	10,722,619	8,825,411	7,714,151
Total net position	\$ 11,387,851	\$ 9,508,598	\$ 8,299,585

Assets. As of June 30, 2015, The Fund's assets totaled \$13,071,139. Cash and cash equivalents, totaling \$10,308,038 or 78.9% of total assets, represented The Fund's most significant asset. Accounts receivable (primarily for dental services), net of allowances, totaled \$2,104,960 or 16.1% of total assets and was The Fund's second largest asset.

Total assets increased \$2,228,513 during the year ended June 30, 2015, a result of increases in cash and cash equivalents of \$3,995,207, accounts receivable, net of allowances of \$167,683, endowment investments of \$28,649 and prepaid expenses of \$1,320 offset by a decrease in other receivables of \$1,964,346.

Liabilities. At June 30, 2015, The Fund's liabilities totaled \$1,683,288. Amounts due to the University for faculty salary supplements of \$934,329 represent 55.5% of total liabilities. Accounts payable and accrued liabilities of \$661,345 and unearned revenue of \$87,614 comprised the remainder of The Fund's liabilities.

Total liabilities increased \$349,260 during the year ended June 30, 2015. This increase was due to increases in accounts payable and accrued liabilities, due to the University and unearned revenue.

Net Position. Net position at June 30, 2015, totaled \$11,387,851 or 87.1% of total assets. Restricted net position totaled \$665,232 or 5.8% of total net position and unrestricted net position accounted for \$10,722,619 or 94.2% of total net position.

2014 Versus 2013. During the year ended June 30, 2014:

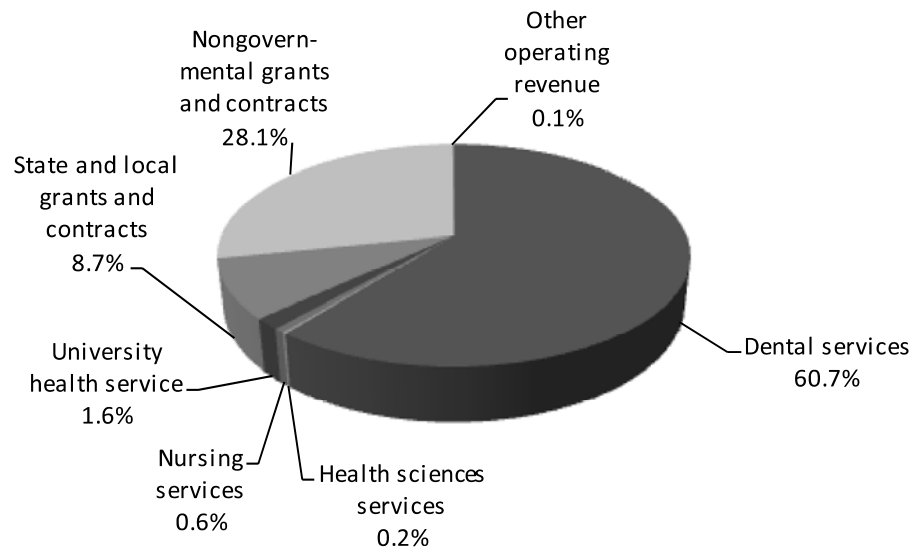
- Total assets increased \$1,212,068 or 12.6%. This increase was driven primarily by an increase in other receivables offset by decreases in cash and cash equivalents, accounts receivable, net of allowances and endowment investments.
- Total liabilities increased \$3,055, due to increases in accounts payable and accrued liabilities and due to the University, offset by a decrease in unearned revenue.
- Total net position increased \$1,209,013, primarily due to increases in unrestricted net position.

Condensed Statements of Revenues, Expenses and Changes in Net Position

	<u>2015</u>	<u>2014</u>	<u>2013</u>
OPERATING REVENUES			
Professional service fees, net of allowances			
Dental services	\$13,630,682	\$13,036,372	\$12,532,753
Health sciences services	47,413	49,004	99,217
Nursing services	144,151	259,308	650,130
University health service	361,879	391,726	466,786
Total professional service fees	<u>14,184,125</u>	<u>13,736,410</u>	<u>13,748,886</u>
State and local grants and contracts	1,954,494	999,864	981,473
Nongovernmental grants and contracts	6,310,809	9,193,243	6,748,335
Other operating revenue	25,625	44,837	83,884
Total operating revenues	<u>22,475,053</u>	<u>23,974,354</u>	<u>21,562,578</u>
OPERATING EXPENSES			
Educational and general	11,450,036	13,472,287	9,784,488
Total operating expenses	<u>11,450,036</u>	<u>13,472,287</u>	<u>9,784,488</u>
NET INCOME FROM OPERATIONS	<u>11,025,017</u>	<u>10,502,067</u>	<u>11,778,090</u>
NONOPERATING REVENUES (EXPENSES)			
Gifts and grants	190,148	207,585	107,184
Investment income	9,305	29,141	37,162
Grants to the University of Kentucky	<u>(9,345,217)</u>	<u>(9,529,780)</u>	<u>(12,827,638)</u>
Total nonoperating revenues (expenses)	<u>(9,145,764)</u>	<u>(9,293,054)</u>	<u>(12,683,292)</u>
Total increase (decrease) in net position	1,879,253	1,209,013	(905,202)
Net position, beginning of year	<u>9,508,598</u>	<u>8,299,585</u>	<u>9,204,787</u>
Net position, end of year	<u>\$11,387,851</u>	<u>\$ 9,508,598</u>	<u>\$ 8,299,585</u>

2015. Total operating revenues were \$22,475,053 for the year ended June 30, 2015. The most significant source of operating revenues for The Fund was professional service fees, primarily dental, of \$14,184,125 or 63.1% of the total. Operating revenues decreased \$1,499,301 or 6.3%, mainly due to a decrease in nongovernmental grants and contracts of \$2,882,434 offset by increases in state and local grants and contracts and dental services. The decrease is primarily due to a decrease in revenue from the College of Medicine to cover expenditures by the Dean's Academic Enrichment account.

TOTAL OPERATING REVENUES



Operating expenses totaled \$11,450,036. This entire amount was used for educational and general expenses related to functions such as academic support, public service, student financial aid and student services. Operating expenses decreased \$2,022,251 or 15.0% primarily in Dean's Academic Enrichment account due to decreases in salary and benefits and scholarships. Nonoperating expenses decreased \$147,290 primarily in grants to the University for non-capital and capital purposes.

2014 Versus 2013. During the year ended June 30, 2014:

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

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.

	2015	2014	2013
CASH PROVIDED (USED) BY:			
Operating activities	\$ 13,040,924	\$ 8,482,186	\$ 11,572,636
Noncapital financing activities	(9,114,391)	(9,291,403)	(11,185,643)
Capital and related financing activities	88,018	(3,807)	1,582,189
Investing activities	(19,344)	134,404	(14,711)
Net increase (decrease) in cash and cash equivalents	3,995,207	(678,620)	(1,209,907)
Cash and cash equivalents, beginning of year	<u>6,312,831</u>	<u>6,991,451</u>	<u>8,201,358</u>
Cash and cash equivalents, end of year	<u><u>\$ 10,308,038</u></u>	<u><u>\$ 6,312,831</u></u>	<u><u>\$ 6,991,451</u></u>

2015. The major sources of funds included in operating activities were professional service fees of \$14,031,874 and grants and contracts of \$10,224,320. The largest cash payments for operating activities were made to vendors and contractors of \$7,726,850.

Cash used in the noncapital financing activities group consisted of \$9,304,539 in grants to the University of Kentucky offset by receipt of private gifts and grants of \$190,148.

Cash provided by capital and related financing activities was related to grants of capital assets from the University of Kentucky.

Cash used by investing activities included \$30,738 on the purchase of investments offset by the sale of investments net of \$3,597 and interest and dividend income of \$7,797.

2014 Versus 2013. From June 30, 2013 to June 30, 2014 cash decreased \$678,620 due to a decrease in cash provided by operating activities along with a decrease in cash used by noncapital financing activities offset by an increase in cash provided from investing activities along with a decrease in cash used for capital and related financing activities.

Capital Asset and Debt Administration

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

Debt. The Fund had no debt at or during the year ended June 30, 2015.

Factors Impacting Future Periods

In June 2015, the Board of Directors authorized the dissolution of the Fund effective June 30, 2016. The assets of the Fund will be transferred to the University in accordance with the Articles of Dissolution on July 1, 2016.

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, 2015 AND 2014

	<u>2015</u>	<u>2014</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 10,308,038	\$ 6,312,831
Accounts receivable, net	2,104,960	1,937,277
Other receivables	491,549	2,455,895
Prepaid expenses	1,320	-
Total current assets	<u>12,905,867</u>	<u>10,706,003</u>
Noncurrent Assets		
Endowment investments	165,272	136,623
Total noncurrent assets	<u>165,272</u>	<u>136,623</u>
Total assets	<u>13,071,139</u>	<u>10,842,626</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	661,345	450,884
Unearned revenue	87,614	77,511
Due to the University of Kentucky	934,329	805,633
Total current liabilities	<u>1,683,288</u>	<u>1,334,028</u>
Total liabilities	<u>1,683,288</u>	<u>1,334,028</u>
NET POSITION		
Restricted		
Nonexpendable	30,642	30,642
Expendable	634,590	652,545
Total restricted	<u>665,232</u>	<u>683,187</u>
Unrestricted		
Total net position	<u>\$ 11,387,851</u>	<u>\$ 9,508,598</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, 2015 AND 2014**

	<u>2015</u>	<u>2014</u>
OPERATING REVENUE		
Professional service fees, net of allowances:		
Dental services	\$ 13,630,682	\$ 13,036,372
Health sciences services	47,413	49,004
Nursing services	144,151	259,308
University health service	361,879	391,726
Total professional service fees	<u>14,184,125</u>	<u>13,736,410</u>
State and local grants and contracts	1,954,494	999,864
Nongovernmental grants and contracts	6,310,809	9,193,243
Other operating revenues	25,625	44,837
Total operating revenues	<u>22,475,053</u>	<u>23,974,354</u>
OPERATING EXPENSES		
Educational and general:		
Instruction	1,028,201	981,531
Research	179,590	302,379
Public service	3,549,858	3,153,821
Academic support	3,812,315	4,646,535
Student services	1,037,923	1,094,444
Institutional support	124,746	122,071
Operations and maintenance	390,913	236,835
Student financial aid	1,266,200	2,875,977
Hospital and clinics	60,290	58,694
Total operating expenses	<u>11,450,036</u>	<u>13,472,287</u>
Net income from operations	<u>11,025,017</u>	<u>10,502,067</u>
NONOPERATING REVENUES (EXPENSES)		
Gifts and grants	190,148	207,585
Investment income	9,305	29,141
Grants to the University of Kentucky for non-capital purposes	(9,433,235)	(9,525,973)
Net nonoperating revenues (expenses)	<u>(9,233,782)</u>	<u>(9,289,247)</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>1,791,235</u>	<u>1,212,820</u>
Grants (to) from the University of Kentucky for capital purposes	88,018	(3,807)
Total other revenues (expenses)	<u>88,018</u>	<u>(3,807)</u>
Increase (decrease) in net position	1,879,253	1,209,013
NET POSITION, beginning of year	<u>9,508,598</u>	<u>8,299,585</u>
NET POSITION, end of year	<u>\$ 11,387,851</u>	<u>\$ 9,508,598</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, 2015 AND 2014**

	<u>2015</u>	<u>2014</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Professional service fees	\$ 14,031,874	\$ 14,003,915
Payments to vendors and contractors	(7,726,850)	(6,998,645)
Student financial aid	(1,266,200)	(2,875,977)
Salary, wage and benefit reimbursements to the University of Kentucky	(2,247,845)	(3,560,720)
Grants and contracts	10,224,320	7,868,776
Other receipts (payments)	25,625	44,837
Net cash provided (used) by operating activities	<u>13,040,924</u>	<u>8,482,186</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts and grants received for other than capital purposes	190,148	207,585
Grants (to) from the University of Kentucky	(9,304,539)	(9,498,988)
Net cash provided (used) by noncapital financing activities	<u>(9,114,391)</u>	<u>(9,291,403)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	88,018	(3,807)
Net cash provided (used) by capital and related financing activities	<u>88,018</u>	<u>(3,807)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	3,597	199,916
Interest and dividends on investments	7,797	7,360
Purchase of investments	(30,738)	(72,872)
Net cash provided (used) by investing activities	<u>(19,344)</u>	<u>134,404</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>3,995,207</u>	<u>(678,620)</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>6,312,831</u>	<u>6,991,451</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 10,308,038</u>	<u>\$ 6,312,831</u>
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	\$ 11,025,017	\$ 10,502,067
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Change in assets and liabilities:		
Accounts receivable, net and other receivables	1,796,663	(1,995,951)
Accounts payable and accrued liabilities	210,461	32,059
Unearned revenue	10,103	(55,989)
Prepaid expenses	(1,320)	-
Net cash provided (used) by operating activities	<u>\$ 13,040,924</u>	<u>\$ 8,482,186</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
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 of Kentucky (the Commonwealth) in July 2010, the University employs a total return method for establishing investment objectives and spending policies designed to achieve financial equilibrium for endowment funds over the long term. The University makes expenditure decisions in accordance with UPMIFA and donor gift agreements. UPMIFA prescribes guidelines for expenditure of a donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations) and focuses on the entirety of a donor-restricted endowment fund, that is, both the original gift amount(s) and net appreciation. In accordance with the standard of prudence prescribed by UPMIFA and consistent with industry standards, the University has adopted a spending policy with the long-term objective to maintain the purchasing power of each endowment and provide a predictable and sustainable level of income to support current operations.

Effective for fiscal year 2015 and thereafter 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 is calculated by taking a weighted average comprising 60% of the prior year’s spending, adjusted for inflation, and 40% of the amount that results when the target annual spending rate of four percent is applied to the average market value of the endowment over the preceding 36 months. The spending amount determined by the formula is constrained so that the calculated rate is at least three percent, and not more than six percent, of the current endowment market value. For fiscal year 2014, spending was based on four percent of the average endowment market value for the preceding 60 months.

The University also utilizes an endowment management fee to support internal management and fundraising costs related to the endowment. For the years ended June 30, 2015 and 2014, the University’s annual endowment management fee was 0.25%.

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

The amount of gross spending policy distribution in accordance with the University’s endowment spending policy was \$5,129 and \$29,197 for the years ended June 30, 2015 and 2014, 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. (an entity with which the University's faculty in its College of Medicine have "Practice Agreements and Assignments") have an agreement whereby The Fund receives clinical income only on a need basis for the years ended June 30, 2015 and 2014 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.

Electronic Health Records Incentive Program. The Electronic Health Records Incentive Program, enacted as part of *the American Recovery and Reinvestment Act of 2009*, provides for incentive payments under both the Medicare and Medicaid programs to eligible entities that demonstrate meaningful use of certified electronic health records technology. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under the Medicaid program is contingent on The Fund continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Fund recognizes revenue when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In fiscal year 2015, the Fund completed the first-year requirements under the Medicaid program and recorded revenue of \$297,500, which is included in State and local grants and contracts within operating revenues in the statement of revenues, expenses, and changes in net position.

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, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
Cash on deposit with the University	\$ 10,308,038	\$ 6,312,831
Investment in University pooled endowment fund	<u>165,272</u>	<u>136,623</u>
Total	<u>\$ 10,473,310</u>	<u>\$ 6,449,454</u>

The composition of the University's pooled endowment fund based upon fair value at June 30, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
Cash and cash equivalents	0.4%	0.4%
Common and preferred stock	3.5%	4.6%
Corporate fixed income funds	0.7%	0.5%
Government agency fixed income funds	0.2%	0.2%
Pooled absolute return funds	10.0%	11.6%
Pooled equity funds	26.2%	28.3%
Pooled fixed income funds	7.3%	7.5%
Pooled global tactical asset allocation funds	7.2%	7.6%
Pooled long/short equity funds	14.2%	12.1%
Pooled private equity funds	12.8%	9.9%
Pooled real estate funds	8.5%	6.7%
Pooled real return funds	8.3%	9.6%
U.S. Treasury fixed income	<u>0.7%</u>	<u>1.0%</u>
Total	<u>100.0%</u>	<u>100.0%</u>

Deposit and Investment Policies. The Fund follows the deposit and investment policies established by the University's Board of Trustees. Such policies are developed to establish and maintain sound financial management practices for the investment and management of The 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, 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, 2015, The Fund had no underlying investments in any one issuer which represented 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, 2015 is as follows:

	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 2,765,924	\$ (696,017)	\$ 2,069,907
University health service patient accounts	35,053	-	35,053
Kentucky Medical Services Foundation receivable	465,314	-	465,314
Other receivables	26,235	-	26,235
Total	<u>\$ 3,292,526</u>	<u>\$ (696,017)</u>	<u>\$ 2,596,509</u>

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
Kentucky Medical Services Foundation receivable	2,424,331	-	2,424,331
Other receivables	31,564	-	31,564
Total	<u>\$ 5,083,629</u>	<u>\$ (690,457)</u>	<u>\$ 4,393,172</u>

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Payable to vendors and contractors	\$ 358,363	\$ 164,213
Credit balances on patient accounts	270,264	262,404
Due to the University of Kentucky for accrued payroll	<u>32,718</u>	<u>24,267</u>
Total	<u>\$ 661,345</u>	<u>\$ 450,884</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>2015</u>	<u>2014</u>
Working capital needs	\$ 2,597,829	\$ 4,393,172
Budget appropriations for operating purposes for the upcoming fiscal year	1,929,900	1,955,200
Available for future operating purposes	<u>6,194,890</u>	<u>2,477,039</u>
Total	<u>\$ 10,722,619</u>	<u>\$ 8,825,411</u>

6. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Interest and dividends earned on endowment investments	\$ 1,705	\$ 2,370
Realized and unrealized gains and losses on endowment investments	1,508	21,781
Interest on cash and non-endowment investments	<u>6,092</u>	<u>4,990</u>
Total	<u>\$ 9,305</u>	<u>\$ 29,141</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 2014 to 2015. 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. SUBSEQUENT EVENTS

In June 2015, the Board of Directors authorized the dissolution of The Fund effective June 30, 2016. All of the liabilities of The Fund will be paid or discharged and all assets held by The Fund will transfer to the University of Kentucky according to the Articles of Dissolution of The Fund on July 1, 2016.

BOARD OF DIRECTORS

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