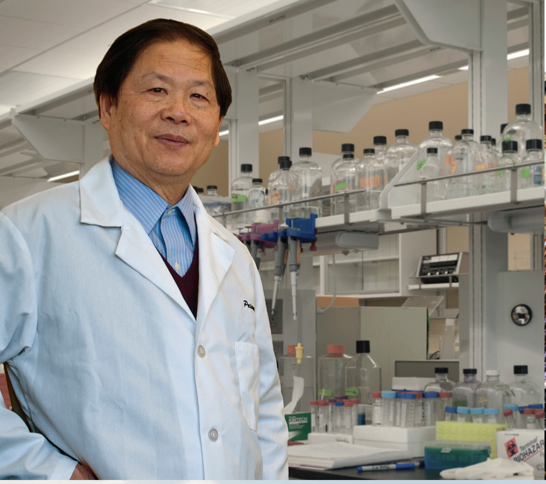

UK HealthCare Hospital System

2014 Financial Statements

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UK HealthCare Hospital System
An Organizational 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 Trustees
University of Kentucky
UK HealthCare Hospital System
Lexington, Kentucky

We have audited the accompanying statements of net position of UK HealthCare Hospital System (System), an organizational unit of the University of Kentucky (University), a component unit of the Commonwealth of Kentucky, as of June 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the financial statements, which collectively comprise the System's basic financial statements.

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 System'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 System'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 System 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.

Emphasis of Matters

As discussed in Note 1, the financial statements of the System are intended to present the financial position, the changes in financial position and cash flows of only that portion of the business-type activities that is attributable to the transactions of the System. They do not purport to, and do not, present fairly the financial position of the University as of June 30, 2014 and 2013, the changes in its financial position or its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 1 to the financial statements, during 2014 the University implemented the provisions of Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which changed its method of accounting for bond issuance costs through retroactive application to prior years' financial statements. Our opinion is not modified with respect to this matter.

Other Matter

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 audits 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.

BKD, LLP

Louisville, Kentucky
October 3, 2014

Management's Discussion and Analysis

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of the UK HealthCare Hospital System for the years ended June 30, 2014 and 2013. UK HealthCare Hospital System includes Albert B. Chandler University Hospital, including Kentucky Children's Hospital (collectively Chandler); UK HealthCare Good Samaritan Hospital (Good Samaritan); and Kentucky Healthcare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary (collectively, the System). Management has prepared this discussion, and we encourage you to read it in conjunction with the financial statements and the notes appearing in this report.

About UK HealthCare System

UK HealthCare, a trademarked brand used by the University of Kentucky (the University) for its health care services, is uniquely equipped to provide advanced subspecialty care to the people of Kentucky. The academic medical center and health system provides patient care on par – in terms of both volume and complexity – with the nation's top 25 percent of academic medical centers. In October 2013, UK HealthCare was named a "Rising Star" by the University HealthSystem Consortium (UHC) for gains made in quality, safety, efficiency and equity of care. This and other notable achievements are listed at http://ukhealthcare.uky.edu/quality/awards/.

UK HealthCare Hospital System operates two hospital units under one Joint Commission Accreditation and two licenses in addition to ambulatory services. The major service units include Albert B. Chandler Hospital, Good Samaritan Hospital and the Kentucky Clinic. The hospitals have a combined total of 825 licensed beds with an average daily census of 670 patients. On a monthly basis, the system provides over 1,200 inpatient surgeries, 1,280 outpatient surgeries, 29,360 radiology procedures, 7,595 emergency department visits and 98,335 hospital based outpatient clinic visits.

Under a management contract entered into with the Kentucky Cabinet for Health and Family Services (CHFS), UK HealthCare Hospital System also operates and manages Eastern State Hospital, a 300,000 square-foot facility located on the University's Coldstream Research Campus. The new psychiatric facility, opened in September 2013, provides a modern setting for both acute and long-term inpatient psychiatric treatment for adults living within Fayette County and the 50 surrounding counties.

UK HealthCare's Markey Cancer Center remains the state's only cancer center designated by the National Cancer Institute (NCI), which reflects the University's position as a frontrunner in cancer treatment and research. UK HealthCare is one of an elite group of only 22 medical centers in the United States that have NCI designation, a federally funded Center on Aging, and a highly prized Clinical and Translational Science Award grant (CTSA).

UK HealthCare's dramatic growth within the last decade is in large part the result of a commitment to support the state's overall system of care by working hand-in-hand with local community providers to bring specialty care closer to the patient. These relationships take on different dimensions in each locality (management agreements, affiliate networks, outreach, etc.) and support keeping less acute care in the local community and smoothing the process for more complex, serious cases to be treated in UK HealthCare's Lexington facilities. The goal is better care at all points of the continuum.

Financial Highlights

The System's overall financial position remains strong with assets of $1.37 billion and liabilities of $547.4 million. Net position, which represents the System's residual interest in assets after liabilities are deducted, was $821.7 million or 60.0% of total assets. For the fiscal year ended June 30, 2014, the System reported net income before other revenues, expenses, gains and losses of $131.0 million, generating a margin of 11.7%.

Financial results for fiscal year 2014 exceeded prior year revenues with net inpatient revenues, including the provision for doubtful accounts, increasing approximately $63.5 million or 10.4% over the prior fiscal year and net outpatient revenues, including the provision for doubtful accounts, increasing $49.0 million or 15.4% over the previous fiscal year. The change in net patient service revenue is primarily the result of increases in rates, an overall increase in the case mix index, improvements in payer mix and increased outpatient activity.

- Total assets increased $109.1 million or 8.7%. This increase is due to increases in cash and cash equivalents of $56.5 million, accounts receivable, $2.3 million, inventories of $2.8 million, estimated third-party receivables of $6.5 million, long-term investments of $36.0 million, other assets $2.1 million, and capital assets, net, of $3.8 million, This increase was offset by decreases in accrued interest receivable of $20,000, and notes receivable of $1.0 million.
- Total liabilities decreased $12.6 million or 2.3%, as a result of decreases of $8.4 million in estimated third party payer settlements, $13.3 million in long-term debt due to $10.9 million in payments on outstanding debt, a $2.5 million net decrease in the amount due to the University of Kentucky and $21.1 million in capital lease obligations. These decreases were offset by increases in current accounts payable and accrued expenses of $30.5 million and $617,000 in unearned revenue.
- Total net position increased $121.7 million or 17.4%, primarily due to the current year net income.
- Operating revenues increased $163.6 million or 17.2%, primarily due to new management contract revenue and increase in net patient revenue.
- Operating expenses increased $127.4 million or 14.4% due primarily to the addition of management contract expenses of $33.3 million, increases in supplies, personnel costs, depreciation and other expenses.
- The net nonoperating revenues increase of $15.2 million resulted from an $11.3 million increase in investment income, a $1.2 million increase in other, a $1.2 million increase in gifts, a $1.2 million decrease in interest expense and a $310,000 increase in gain of disposal of capital assets.

Operating Statistics

The following table presents utilization statistics for the System for fiscal years ended 2014, 2013 and 2012:

	2014	2013	2012
Discharges:			
Medicare	11,888	11,322	10,857
Medicaid	11,035	9,911	9,670
Commercial/Blue Cross	9,560	10,278	9,718
Patient/Charity	2,697	4,000	4,208
Total discharges	35,180	35,511	34,453
Average daily census	627	577	560
Average length of stay	6.50	5.93	5.95
Outpatient visits:			
Hospital clinics	428,582	368,223	359,011
Emergency visits	91,146	88,752	89,662
Total visits	519,728	456,975	448,673

2014. Total discharges decreased by 331 or 0.9% compared to the prior fiscal year. The decrease occurred primarily due to decreases in Patient/Charity discharges of 1,303 and Commercial/Blue Cross of 718. These decreases were slightly offset by increases in Medicare discharges of 556 and Medicaid discharges of 1,124.

Overall the Diagnosis-Related Group (DRG) case mix index increased to 1.9055 from 1.8193 and the average length of stay increased by 0.57 days to 6.50 days. The case mix for Chandler was at 1.9994 while Good Samaritan was at 1.3336.

Total outpatient visits increased by 62,753 or 13.7% over the prior year.

Using the Financial Statements

The System presents its financial reports in a "business type activity" format, in accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. In addition to this MD&A section, the financial report includes a Statement of Net Position, a Statement of Revenues, Expenses and Changes in Net Position, a Statement of Cash Flows and Notes to the Financial Statements. GASB requires that statements be presented on a System-wide basis.

Reporting Entity

The System is an organizational unit of the University of Kentucky (the University), which is a component unit of the Commonwealth of Kentucky (the Commonwealth) and is included in the basic financial statements of the Commonwealth. The financial statements of the System include Kentucky Healthcare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary. The System provides inpatient, outpatient and emergency care services for residents of the Commonwealth.

Statement of Net Position

The Statement of Net Position is the System's balance sheet. It reflects the total assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position (equity) of the System as of June 30, 2014, with comparative information as of June 30, 2013. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Net position, the difference between total assets, deferred outflows of resources, total liabilities, and deferred inflows of resources, is an important indicator of the System's current financial condition, while the change in net position is an indicator of whether the overall financial position has improved or worsened during the year. Generally, assets, deferred outflows of resources, liabilities, and deferred inflows of resources are reported using current values. A major exception is capital assets, which are stated at historical cost, less accumulated depreciation. A summarized comparison of the System's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position at June 30, 2014, 2013 and 2012 follows:

Condensed Statements of Net Position (in thousands)

	2014	2013 (Restated)	2012 (Restated)
ASSETS			
Current assets	$ 263,486	$ 197,394	$ 184,714
Capital asset, net	808,779	804,938	823,978
Other noncurrent assets	296,804	257,664	234,892
Total Assets	1,369,069	1,259,996	1,243,584
LIABILITIES			
Current liabilities	149,852	131,052	173,094
Noncurrent liabilities	397,500	428,948	434,388
Total Liabilities	547,352	560,000	607,482
NET POSITION			
Net investment in capital assets	410,348	373,346	387,039
Nonexpendable other	118	117	118
Restricted expendable	10,331	14,965	14,529
Unrestricted	400,920	311,568	234,416
Total Net Position	$ 821,717	$ 699,996	$ 636,102

Assets. As of June 30, 2014, the System's total assets amounted to approximately $1.37 billion. Capital assets, net of depreciation, of $808.8 million or 59.1% represented the System's largest asset. Long-term investments of $268.9 million or 19.6% of total assets were the System's second largest asset. Accounts receivable, primarily patient-related, of $122.2 million or 8.9% represents another significant asset of the System. Cash and cash equivalents totaled $111.7 million or 8.2% of total assets.

Total assets increased by $109.1 million during the year ended June 30, 2014. The increase was the result of several factors: unrestricted and restricted cash increased $56.5 million primarily from an increase from operating activities of $161.2 million, which was offset by reduced noncapital financial activities of $2.3 million and an increase in cash used for capital and related financing activities of $102.8 million. In addition, long-term investments increased $36.0 million due to the endowment posting a gain of 15.5%, capital assets, net increased $3.8 million due to construction projects, purchases of capital equipment, and software development, accounts receivable, net, increased $2.3 million, inventories increased $2.8 million, estimated third-party payer settlements receivable increased $6.5 million and other assets increased $2.1 million. These increases were offset by decreases in notes receivable of $533,000, and in accrued interest receivable of $20,000.

Liabilities. At June 30, 2014, the System's liabilities totaled approximately $547.4 million. Long-term debt and long-term liabilities, which consists of general receipts project notes and note payable to the University, comprised the largest liability of $350.8 million or 64.1% of total liabilities. Capital lease obligations totaled $72.4 million or 13.2% of liabilities. Current accounts payable and accrued expenses represented approximately $111.2 million or 20.3% of liabilities. Long-term liabilities, other, primarily unamortized bond premium, totaled $5.3 million or 1.0% of liabilities. Total liabilities decreased $12.6 million primarily due to decreases in capital lease obligations of $21.1 million, in long-term debt of $13.3 million and in estimated third-party payer settlements of $8.4 million offset by an increase of current accounts payable and accrued expenses of $30.5 million.

Net Position. Net position at June 30, 2014 totaled approximately $821.7 million, or 60.0% of total assets. Net investment in capital assets totaled $410.3 million or 49.9% of total net position. Restricted net position totaled approximately $10.4 million or 1.3% of total net position. Unrestricted net position accounted for $400.9 million or 48.8% of total net position. Total net position increased $121.7 million or 17.4%.

Restricted net position is subject to externally imposed restrictions governing their use. Although unrestricted net position is not subject to externally imposed stipulations, substantially all of the unrestricted net position has been internally designated for capital projects and working capital requirements.

2013 Versus 2012. When comparing the fiscal year ended June 30, 2013 to the year ended June 30, 2012:

- Total assets increased by $16.4 million, primarily due an increase in unrestricted and restricted cash of $37.8 million from reduced spending on capital and related financing activities, and increase in long-term investments of $24.8 million due to the endowment posting a gain of 11.5%, accounts receivable, net, increased $3.1 million and inventories increased $1.5 million offset by decreases in estimated third-party payer settlements receivable of $30.1 million, in capital assets, net, of $19.0 million, and in other assets of $2.4 million.

- Total liabilities decreased $47.4 million primarily due to paying off the noncapital loan to the University of $47.9 million.

- Total net position increased $63.9 million, primarily due to a net gain for the year related to net income from continuing operations.

Statement of Revenues, Expenses and Changes in Net Position

The Statement of Revenues, Expenses and Changes in Net Position is the System's income statement. It details how net position has fluctuated during the year ended June 30, 2014, with comparative information for the year ended June 30, 2013. This statement 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. All items that increase or decrease net position must appear on the Statement of Revenues, Expenses and Changes in Net Position as revenues, expenses, gains or losses.

Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts and investment income to be classified as nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

Condensed Statements of Revenues, Expenses and Changes in Net Position
(in thousands)

	2014	2013 (Restated)	2012 (Restated)
OPERATING REVENUES			
Net patient service revenues	$ 1,039,264	$ 926,811	$ 888,714
Sales and services	39,833	24,639	24,112
Management contract revenue	35,910	-	-
Total operating revenues	1,115,007	951,450	912,826
OPERATING EXPENSES			
Salaries and wages	306,265	279,001	274,979
Fringe benefits	87,533	79,803	77,973
Supplies	240,898	210,363	200,800
Purchased services	168,654	166,597	164,720
Other expenses	125,414	99,183	106,323
Depreciation	51,460	51,261	45,643
Management contract expenses	33,348	-	-
Total operating expenses	1,013,572	886,208	870,438
NET INCOME FROM CONTINUING OPERATIONS	101,435	65,242	42,388
NONOPERATING REVENUES (EXPENSES)			
State appropriations	1,053	1,053	1,053
Gifts and non-exchange grants	7,806	6,653	4,797
Investment income (loss)	37,144	25,839	(336)
Interest expense	(18,541)	(19,779)	(19,891)
Gain (loss) on disposal of capital assets	310	-	2,161
Other	1,752	584	579
	29,524	14,350	(11,637)
Net income (loss) before other revenues, expenses, gains or losses	130,959	79,592	30,751
Transfer (to) from the University of Kentucky-noncapital	(11,128)	(17,373)	(17,277)
Transfer (to) from the University of Kentucky-capital	1,890	1,675	(213)
DISCONTINUED OPERATIONS			
Net loss from discontinued operations	-	-	(16)
Total increase in net position	121,721	63,894	13,245
Net position, beginning of year, as previously reported	-	-	625,110
Cumulative effect of adoption of accounting principle	-	-	(2,253)
Net position, beginning of year, as restated	699,996	636,102	622,857
Net position, end of year	$ 821,717	$ 699,996	$ 636,102

Operating Revenues:

Total operating revenues were approximately $1.12 billion for the year ended June 30, 2014, an increase of $163.6 million or 17.2% over fiscal year 2013. The most significant source of operating revenue for the System was net patient service revenues of $1.04 billion, an increase of $112.5 million or 12.1% in fiscal year 2014 over 2013.

Inpatient net revenue, including bad debt, increased $63.5 million over prior year. Rate was the primary driver of the increase which can be partially attributed to a 4.7% increase in acuity, with case mix index closing the year at 1.9055. In addition, a favorable payor mix change driven by Medicaid expansion saw self-pay inpatient case volume decrease by 1,303 over prior year, while Medicaid grew by 1,124 cases.

Outpatient net revenue, including bad debt, increased by $49.0 million or 15.4% or over prior year. Rate change accounted for $5.4 million of the increase and is attributed to gross revenue rate adjustments, Medicaid expansion and improvements in contractual agreements. Outpatient activity increased by 12.1% over fiscal year 2013 and drove the remaining $43.7 million of the favorable variance over prior year.

Bad debt decreased by $12.0 million or 8.3% over prior year. The decrease was primarily associated with a decline in the uninsured self-pay patient population due to Medicaid expansion which took effect in January 2014.

The following table shows net patient revenue by funding source for fiscal years ended June 30, 2014, 2013 and 2012 (in thousands):

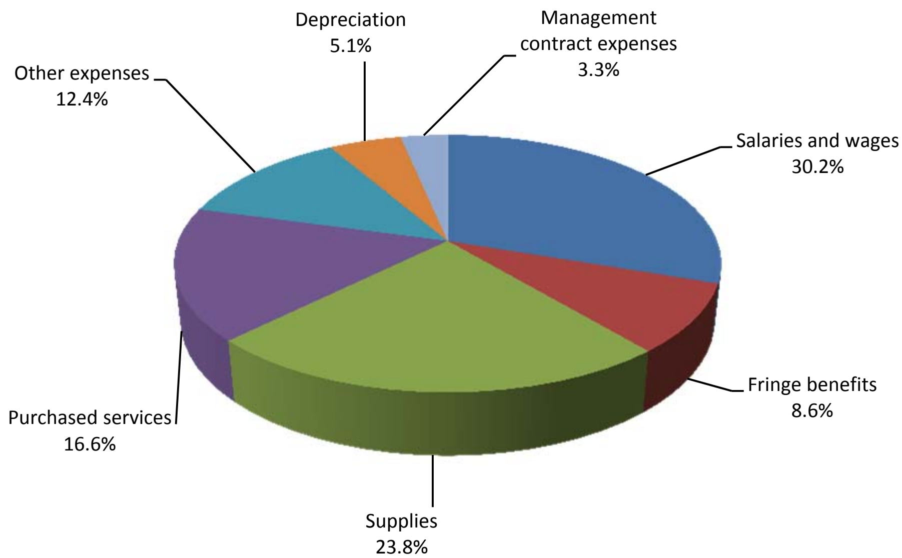
Payer	2014		2013		2012	
Medicare	$	293,394	$	260,470	$	259,310
Medicaid		279,784		247,313		240,351
Commercial/Blue Cross		502,193		468,165		418,509
Patient/charity		97,105		96,071		105,080
Bad debt		(133,212)		(145,208)		(134,536)
Total	$	1,039,264	$	926,811	$	888,714

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The System receives additional payments for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement and outlier payments on cases with unusually high costs of care. The System’s outpatient care is reimbursed under a prospective payment system. Medicare reimburses the System for allowable costs at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. Settlements with the Medicare program for prior years’ cost reports are recognized in the year the settlement is resolved.

Net revenues for Medicaid represent payments for services provided to Medicaid beneficiaries. Payments for inpatient services are paid on a per discharge basis and include Intensity Operating Allowance revenues, which are intergovernmental transfer payments available for public institutions to assure access to medical care for Medicaid participants. Outpatient services are reimbursed based upon a combination of fee schedule, per case and retrospective cost settlement basis.

Net revenues for patient/charity include reimbursement for uncompensated care by the Commonwealth from Disproportionate Share System funds.

TOTAL OPERATING EXPENSES



Operating Expenses:

Total operating expenses, including $51.5 million of depreciation, were $1.01 billion, an increase of $127.4 million or 14.4% over the prior year.

Salaries and wages increased by $27.3 million over the prior fiscal year. The increase in salary and wage was driven by a FTE increase of 423, a 7.3% increase over prior year. This was compounded by an increase in rate per FTE as a result of various market adjustments for specific clinical personnel groups such as registered nurses, nursing techs and respiratory techs. Fringe benefits increased $7.7 million or 9.7%. Management contract expenses related to Eastern State Hospital were $33.3 million.

Supplies expenses increased by $30.5 million or 14.5% primarily due to increases in overall patient activity. Other expenses increased by $26.2 million or 26.4%, purchased services $2.1 million or 1.2%, and depreciation expense increased $199,000.

Nonoperating Revenues (Expenses):

Total nonoperating revenues, net of expenses, were $29.5 million in fiscal year 2014 compared to net nonoperating revenues, net of expenses, of $14.4 million during the prior fiscal year. This increase is primarily due to a net investment gain of $37.1 million in fiscal year 2014 compared to a net investment gain of $25.8 million in the prior year. The endowment pool posted a total gain of 15.5% for fiscal 2014 versus a total gain of 11.5% in the prior year.

2013 Versus 2012. Total operating revenues were $951.5 million for the fiscal year ended June 30, 2013, an increase of $38.6 million over the year ended June 30, 2012. Essentially all of the increase in operating revenues was due to increased net patient service revenues.

Operating expenses totaled $886.2 million, an increase of $15.8 million over 2012. The increase was caused primarily by higher costs for personnel, medical supplies and depreciation.

Nonoperating revenues, net of expenses, amounted to $14.4 million in fiscal year 2013 compared to net nonoperating expenses of $11.6 million in the prior year. This increase is primarily due to a net investment gain of $25.8 million in fiscal year 2013 compared to a net investment loss of ($336,000) in the prior year.

Statement of Cash Flows

The Statement of Cash Flows details how cash has increased or decreased during the year ended June 30, 2014, with comparative financial information for the year ended June 30, 2013. It classifies the sources and uses of cash into the following categories:

- Operating activities
- Noncapital financing activities
- Capital and related financing activities
- Investing activities

Cash flows associated with the System's expendable net position appear in the operating and noncapital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt and debt repayments. Purchases and sales of investments are reflected in investing activities.

The primary purpose of the Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the System during the year that will allow financial statement readers to assess the System's:

- Ability to generate future net cash flows
- Ability to meet obligations as they become due
- Possible need for external financing

Condensed Statements of Cash Flows (in thousands)

	2014	2013	2012
CASH PROVIDED (USED) BY:			
Operating activities	$ 161,210	$ 144,657	$ 54,570
Noncapital financing activities	(2,264)	(55,791)	38,902
Capital and related financing activities	(102,791)	(54,696)	(109,193)
Investing activities	367	3,666	1,882
Net increase (decrease) in cash and cash equivalents	56,522	37,836	(13,839)
Cash and cash equivalents, beginning of year	55,146	17,310	31,149
Cash and cash equivalents, end of year	$ 111,668	$ 55,146	$ 17,310

2014. The major sources of cash included in operating activities was patient service revenues of $1.03 billion, sales and services of $39.8 million and management contract services of $35.5 million. Cash payments for operating activities were $522.9 million to suppliers, $390.0 million to employees for salaries, wages and fringe benefits and payments on management contract services of $28.3 million.

Cash used by noncapital financing includes transfers to the University of $11.1 million. The cash provided consisted primarily of gifts, state appropriations, and loan payments to the University of Kentucky of $6.2 million, $1.1 million, and $1.6 million respectively.

Capital and related financing activities included payments of $54.1 million for principal and interest on capital leases and long term debt and $49.8 million was expended for purchases of capital assets.

Investing activities included proceeds from sales and maturities of investments of $167.3 million and interest and dividends of $4.2 million. Cash of $171.2 million was used to purchase investments.

2013 Versus 2012. Cash balances increased when comparing fiscal year 2013 versus fiscal year 2012 with a net increase in cash of approximately $37.8 million, primarily due to an increase in patient service revenues and a reduction in capital spending.

Key Ratios

The following table shows key liquidity and capital ratios for fiscal years 2014, 2013, and 2012:

	2014	2013	2012
Days cash on hand	42	24	8
Days of revenue in accounts receivable	43	47	48
Debt service coverage (times)	4.9	2.7	1.6

Days cash on hand increased to 42 days in fiscal year 2014 from 24 days in fiscal year 2013 due to the increase in cash balance of $56.5 million which resulted primarily from the significant increase in net income from continuing operations. Days cash on hand measures the average number of days' expenses the System maintains in cash. Mitigating factors include access to working capital from the University and quasi-endowment investments of $268.9 million.

The days of revenue in accounts receivable measures the average number of days it takes to collect accounts receivable. In fiscal year 2014, days in accounts receivable were 43 compared to 47 days in fiscal year 2013.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The System's ratio for fiscal year 2014 is 3.6 versus 2.7 in fiscal year 2013 due to the increase in net position in fiscal year 2014 compared to fiscal year 2013.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled approximately $808.8 million at June 30, 2014, a net increase of $3.8 million over the prior year end. Significant changes in capital assets during fiscal 2013-2014 included (in millions):

Land, buildings and structures, net additions	$ 7.2
Equipment and vehicles, net additions	14.4
Capitalized software additions	4.2
Artwork	0.1
Construction in process, net additions	18.7
Increase in accumulated depreciation, net	(40.8)
Total	$ 3.8

Debt

At year-end, the System had $321.0 million in general receipts project notes outstanding and a $29.8 million loan due to the University; $14.4 million is included in current liabilities with the remainder long term. In addition, the System had $72.4 million in capital leases.

Economic Factors Impacting Future Periods

The following are known facts and circumstances that will affect future financial results:

- Health care reform has initiated significant change within the United States healthcare system, including material changes to the delivery of healthcare services and the reimbursement paid for such services. UK HealthCare continues to develop and execute strategies in an effort to leverage available opportunities and mitigate negative impacts of this legislation as details of the implementation unfold.
- The federal Health Information Technology for Economic and Clinical Health (HITECH) Act and Patient Protection and Affordable Care (PPAC) Act, enacted in 2009 and 2010 respectively, included an initiative for every American to realize the benefits of an "Electronic Health Record" (EHR) by 2014. The PPAC Act included financial incentives for eligible hospitals and physicians to demonstrate meaningful use of an EHR. The Act also included penalties of up to three percent in reductions to Medicare reimbursement if an EHR is not established by 2014. For the last decade, the hospital has utilized EHR and Computerized Physician Order Entry (CPOE) systems for inpatient care. However, in efforts to fully comply with the legislative requirements, maximize eligible financial incentives, and avoid reimbursement penalties, the system is in the process of implementing the Allscripts EHR solution for outpatient care across the enterprise. Approximately 59% of UK HealthCare clinic sites are operational as of July 2014, with the project slated for completion in fiscal year 2015.
- The US Department of Health and Human Services (DHHS) proposed the replacement of existing ICD-9-CM code sets used by medical coders and billers to report health care diagnoses and procedures with ICD-10 codes effective October 1, 2014. The original implementation deadline was extended to October 1, 2015 and is anticipated to radically change the way medical coding is performed. As a result, ICD-10 will require a significant internal effort to implement and train. UK HealthCare has allocated funding and initiated an organized effort around this project to meet DHHS requirements and the proposed deadline.
- In May 2013 Governor Beshear announced that Kentucky would accept Medicaid Expansion under President Barack Obama's healthcare reform law, extending coverage to adults earning up to 133 percent of the federal poverty line. Since going into effect in January 2014 over 400,000 have enrolled in the program, effectively decreasing the uninsured population in the state. This has resulted in improved financial performance as a result of incremental Medicaid reimbursement and significantly reduced bad debt balances.
- In June 2014, UK HealthCare received board approval to build-out additional infrastructure and patient capacity within its facilities. At an estimated cost of $150.0 million dollars, the project includes funding for two new patient floors, NICU relocation, increased elevator capacity, as well as new kitchen and cafeteria facilities. The investment will create incremental, state of the art bed capacity for continued future clinical growth and quality outcomes. Detailed planning efforts around the project staging and timeline are underway.
- A new central pharmacy will open within Pavilion A in the fall of 2014, which will enable cost savings associated with inventory on hand, compounding and other operating efficiencies. In December 2014, UK Healthcare will open the 8th Floor of the pavilion to cardiovascular patients, providing incremental patient bed and ICU capacity. In addition, a new observation unit will also open within the pavilion in January 2015, which will help improve patient throughput within the health care system.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF NET POSITION (in thousands)
JUNE 30, 2014 AND 2013

	2014	2013 (Restated - Note 1)
ASSETS		
Current Assets		
Cash and cash equivalents	$ 103,253	$ 48,565
Accounts receivable (less allowance for doubtful accounts of $27,669 in 2014 and $35,493 in 2013)	122,186	119,857
Inventories and other assets	25,768	22,973
Accrued interest receivable	6	26
Estimated third-party payer settlements	6,490	-
Notes receivable	5,783	5,973
Total current assets	263,486	197,394
Noncurrent Assets		
Restricted cash and cash equivalents	8,415	6,581
Long-term investments	268,905	232,860
Capital assets, net	808,779	804,938
Notes receivable	14,103	14,929
Other assets	5,381	3,294
Total noncurrent assets	1,105,583	1,062,602
Total assets	1,369,069	1,259,996
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	111,248	80,763
Unearned revenue	7,545	6,928
Estimated third-party payer settlements	-	8,367
Long-term debt - current portion	14,412	13,874
Capital lease obligations - current portion	16,647	21,120
Total current liabilities	149,852	131,052
Noncurrent Liabilities		
Long-term liabilities - other	5,287	6,234
Long-term liabilities - debt	336,426	350,301
Capital lease obligations	55,787	72,413
Total noncurrent liabilities	397,500	428,948
Total liabilities	547,352	560,000
NET POSITION		
Net investment in capital assets	410,348	373,346
Restricted		
Nonexpendable other	118	117
Expendable		
Capital projects	3,404	10,560
Other	6,927	4,405
Total restricted expendable	10,331	14,965
Total restricted	10,449	15,082
Unrestricted	400,920	311,568
Total net position	$ 821,717	$ 699,996

See notes to financial statements.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (in thousands)
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	2014	2013 (Restated - Note 1)
OPERATING REVENUES		
Net patient service revenues, less provision for doubtful accounts of $133,212 in 2014 and $145,208 in 2013	$ 1,039,264	$ 926,811
Sales and services	39,833	24,639
Management contract revenue	35,910	-
Total operating revenues	1,115,007	951,450
OPERATING EXPENSES		
Salaries and wages	306,265	279,001
Fringe benefits	87,533	79,803
Supplies	240,898	210,363
Purchased services	168,654	166,597
Other expenses	125,414	99,183
Depreciation	51,460	51,261
Management contract expenses	33,348	-
Total operating expenses	1,013,572	886,208
Net income from continuing operations	101,435	65,242
NONOPERATING REVENUES (EXPENSES)		
State appropriations	1,053	1,053
Gifts and non-exchange grants	7,806	6,653
Investment income (loss)	37,144	25,839
Interest expense	(18,541)	(19,779)
Gain (loss) on disposal of capital assets	310	-
Other	1,752	584
Net nonoperating revenues (expenses)	29,524	14,350
Net income before other revenues, expenses, gains or losses	130,959	79,592
Transfers (to) the University of Kentucky for noncapital purposes	(11,128)	(17,373)
Transfers (to) from the University of Kentucky for capital purposes	1,890	1,675
Total other revenues (expenses)	(9,238)	(15,698)
INCREASE IN NET POSITION	121,721	63,894
NET POSITION, beginning of year, as previously reported	-	638,224
Cumulative effect of adoption of accounting principle	-	(2,122)
NET POSITION, beginning of year, as restated	699,996	636,102
NET POSITION, end of year	$ 821,717	$ 699,996

See notes to financial statements.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF CASH FLOWS (in thousands)
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013

	2014	2013 (Restated - Note 1)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net patient service revenues	$ 1,026,615	$ 963,373
Sales and services	39,833	24,639
Management contract services	35,461	-
Payments to vendors and contractors	(522,876)	(478,370)
Salaries, wages and fringe benefits	(389,954)	(359,902)
Payments on management contract services	(28,288)	-
Other receipts (payments)	419	(5,082)
Net cash provided by operating activities	161,210	144,657
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	1,053	1,053
Gifts	6,244	6,270
Payments on loans from University of Kentucky departmental units	1,567	3,751
Loans to University of Kentucky departmental units	-	(1,583)
Payments to the University of Kentucky for noncapital purposes	-	(47,909)
Transfers (to) the University of Kentucky for noncapital purposes	(11,128)	(17,373)
Net cash provided (used) by noncapital financing activities	(2,264)	(55,791)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets	-	368
Purchases of capital assets	(49,843)	(31,020)
Principal payments-capital leases and long-term obligations	(34,900)	(30,264)
Interest payments-capital leases and long-term obligations	(19,168)	(19,612)
Proceeds from capital leases	-	25,000
Loans from the University of Kentucky for capital purposes	-	339
Transfers from (to) the University of Kentucky for capital purposes	1,120	493
Net cash (used) by capital and related financing activities	(102,791)	(54,696)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	167,334	195,515
Purchase of investments	(171,151)	(197,134)
Interest and dividends on investments	4,184	5,285
Net cash provided (used) by investing activities	367	3,666
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	56,522	37,836
CASH AND CASH EQUIVALENTS, beginning of year	55,146	17,310
CASH AND CASH EQUIVALENTS, end of year	$ 111,668	$ 55,146
Reconciliation of net income from continuing operations to net cash provided by operating activities:		
Net income from continuing operations	$ 101,435	$ 65,242
Adjustments to reconcile net income from continuing operations to net cash provided (used) by operating activities:		
Depreciation	51,460	51,261
Write off of principal note/lease receivable	735	901
Provision for doubtful accounts	(133,212)	(145,208)
Change in assets and liabilities:		
Accounts receivable	130,883	142,131
Inventories and other	(2,795)	(1,529)
Estimated third-party payer settlements receivable and payable	(14,857)	38,503
Other assets	(390)	(686)
Accounts payable and accrued expenses	27,334	(6,302)
Unearned revenue	617	345
Net cash provided by operating activities	$ 161,210	$ 144,657
NON CASH TRANSACTIONS:		
Transfer of capital assets to (from) UK	$ 770	$ 1,182
Capital lease additions (reductions)	$ (74)	$ 194
Capital asset additions in accounts payable	$ 4,514	$ 951
Capitalized interest, net of investment income	$ 454	$ 17
Amortized bond premium	$ 1,187	$ 318

See notes to financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The UK HealthCare Hospital System (the System) is an organizational unit of the University of Kentucky (the University) which is a component unit of the Commonwealth of Kentucky (the Commonwealth) and is included in the basic financial statements of the Commonwealth. The financial statements of UK HealthCare Hospital System include Albert B. Chandler University Hospital including Kentucky Children's Hospital (collectively Chandler); UK HealthCare Good Samaritan Hospital (Good Samaritan); and Kentucky Healthcare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary.

The System provides inpatient, outpatient and emergency care services for residents of the Commonwealth.

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 System.

  Expendable – Net position whose use by the System is subject to externally imposed stipulations that can be fulfilled by actions of the System pursuant to those stipulations or that expire by the passage of time.

- Unrestricted: Net position whose use by the System is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the System'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 System 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 System considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Noncurrent cash and cash equivalents include the System's plant funds allocated for capital projects, with the exception of unrestricted renewal and replacement cash, which is included in current cash and cash equivalents, and endowment fund cash pending transfer to the custodian for investment. Cash and cash equivalents held by the University's endowment fund managers are included in long-term investments.

Accounts Receivable. The System reports patient accounts receivable for services rendered at net realizable amounts from third-party payers and others. The System provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Inventories. Inventories are stated principally at the lower of average cost or market.

Long-Term Investments. The System's endowment investments are administered as part of the University's pooled endowment funds. All contributing endowments participate in the income and appreciation of the pool on a per unit basis commensurate with their contribution to the pool. New endowments purchase units in the pool at the current 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.

Pooled Endowment 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.

For each of the years ended June 30, 2014 and 2013, management elected to retain the spending distribution in the quasi endowment and the amounts available for spending in accordance with the University's endowment spending policy were $8.1 million and $8.7 million, respectively.

Capital Assets. Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift.

The System capitalizes interest costs as a component of construction in progress, based on the interest cost of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing.

Equipment with a unit cost of $2,000 or more ($1,000 for computers) and having an estimated useful life of greater than one year is capitalized. Institutional software costing more than $400,000 is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings, 10 – 25 years for land and building improvements and infrastructure, 5 – 20 years for equipment and vehicles and 10 years for capitalized software.

Title to all capital assets of the System belongs to the University. The financial information relating to capital assets represents assets that the System occupies and uses. Transfer of capital assets to/from the University represents changes in control of individual assets within divisions of the University from one period to another.

Unearned Revenue. Unearned revenue consists of amounts received from the federal government through the Commonwealth for Disproportionate Share System (DSH) funds and other unearned amounts. The DSH amounts are recognized as revenue over the term of the federal government fiscal year, October 1 – September 30.

Compensated Absences. The amount of vacation leave earned but not taken by employees at June 30, 2014 is recorded as a liability by the System. Temporary disability leave payable upon termination under the University's payout policy is also recorded as a liability on the University's financial statements. Compensated absence liabilities are computed using the pay rates in effect at the statement of net position date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Net Patient Service Revenues. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including contractual allowances and estimated retroactive adjustments under reimbursement programs with third-party payers and include a provision for doubtful accounts. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. Certain inpatient nonacute services and defined medical education costs are paid based on a cost reimbursement methodology. The System is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary.

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for all other services. The System is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicaid fiscal intermediary.

Revenue from the Medicare and Medicaid programs accounted for approximately 25% and 24%, respectively, of the System's net patient service revenues before the provision for doubtful accounts for the year ended June 30, 2014 and approximately 24% and 23%, respectively for the year ended June 30, 2013. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

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

Management Contract Revenue. The System entered into a contract with the Kentucky Cabinet for Health and Family Services (CHFS) to manage Eastern State Hospital (ESH) and Central Kentucky Recovery Center (CKRC). Under the contract the System is reimbursed 100% of the related operating expenses up to a limit of $32,167,264, and $1,514,723, for ESH and CKRC respectively, and the System receives an eight percent management fee. The initial contract term was August 13, 2013 to June 30, 2014 with the option to renew the contract for two additional one-year terms.

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 hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. 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 both programs is contingent on the System 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 System 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 2014, the System was in the third year under the Medicare programs and recorded of $1.7 million , which is included in net patient service revenue within operating revenues in the statement of revenues, expenses, and changes in net position. In fiscal year 2013, the System was in the second year of the programs but did not attest to completion of the second phase and recorded no revenue.

In fiscal year 2014, the System completed the third-year requirements under the Medicaid program and recorded revenue of approximately $564,000, which is included in net patient service revenue within operating revenues in the statement of revenues, expenses, and changes in net position. In fiscal year 2013, the System recorded $2.2 million in revenue.

Charity Care. The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Since the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Income Taxes. The University, of which the System is an organizational unit, is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.100 through 164.280. Accordingly, the University is excluded from federal Income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986, as amended.

Restricted Asset Spending Policy. The System's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination of whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

Operating Activities. The System 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 goods and services received. Nearly all of the System's revenues and expenses are from exchange transactions. Certain revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as non-operating revenues, 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 make 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 contractual allowances, allowances for doubtful accounts, estimated third-party payer settlements and estimated medical claims payable.

Change in Accounting Principle. During 2014, the System adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. GASB Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. GASB Statement No. 65 also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term "deferred" in the financial statement presentations.

Adoption of GASB Statement No. 65 requires that bond issuance costs are expensed when incurred rather than as an asset and amortized over the life of the debt, resulting in a decrease of $2.1 million in beginning net position as of July 1, 2012, and an increase in the change in net position of $131,000 for the year ended June 30, 2013 for the System.

2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2014 and 2013 follows (in thousands):

	2014	2013
Cash on deposit with the University of Kentucky	$ 111,668	$ 55,146
Investment in University of Kentucky pooled endowment funds	268,905	232,860
	$ 380,573	$ 288,006
Statement of Net Position classification:		
Cash and cash equivalents	$ 103,253	$ 48,565
Restricted cash and cash equivalents	8,415	6,581
Long-term investments	268,905	232,860
	$ 380,573	$ 288,006

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 University's Board of Trustees is responsible for establishing deposit and investment policies for the System. Once established, the Board has delegated day-to-day management to the Treasurer of the University. Deposit and investment policies are developed to insure compliance with state laws and regulations, as well as to establish and maintain sound financial management practices.

The System follows Kentucky Revised Statutes (KRS 42.500) for the investment of public funds, which list allowable investment instruments to include: obligations of the United States or a United States government agency; obligations of any corporation of the United States Government; collateralized certificates of deposit; highly rated uncollateralized certificates of deposit, bankers acceptances and commercial paper; highly rated securities issued by a state or local government; and mutual funds comprised of any of the above allowable investments.

For purposes of investment management, the System's deposits and investments can be grouped into three significant categories, as follows:

- Cash on deposit with the University, which the University invests in deposits and repurchase agreements with banks and the Commonwealth;
- Short-term investments managed by the University are held in the University's name by the University's custodian, and
- Endowment investments in the University's pooled endowment fund.

Cash on deposit with the University is managed by the University following the University's Operating Fund Investment Policy.

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.

<u>Deposit and Investment Risks.</u> The System'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.

<u>Credit Risk.</u> Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing the System 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 System'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.
- Short-term investments managed by the University are limited to direct obligations of the U.S. Treasury, other appropriate securities issued by federal agencies, repurchase agreements of U.S. government obligations, and certificates of deposit collateralized by U.S. government obligations or general obligations of the University. Short-term investments held in the Commonwealth's investment pools are subject to the same credit quality requirements as denoted above for bond revenue fund investments.
- Endowment managers are permitted to use derivative instruments to limit credit risk.

<u>Custodial Credit Risk.</u> Custodial credit risk is the risk that, in the event of the failure of the counterparty, the System 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, which are held in the University's name, and deposits and repurchase agreements with the Commonwealth, which are held in the Commonwealth's name. The University maintains records evidencing the System's ownership interest of such balances.
- Short-term investments managed by the University are held in the University's name by the University's custodian. The University maintains records evidencing the System's ownership interest of such balances.

- Endowment investments are held in the University's name by the University's custodian. The University maintains records evidencing the System's ownership interest of such balances.

Concentrations of Credit Risk. The System'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.
- Short-term investments held in the Commonwealth's investment pools are limited as follows: U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers shall not exceed 25% of an individual pool and $25.0 million per issuer, inclusive of commercial paper, bankers' acceptances and certificates of deposit; and U. S. dollar denominated sovereign debt shall not exceed five percent of any individual portfolio and $25.0 million per issuer.
- There is no specific limit on the maximum amount of short-term investments managed by the University that may be invested in one issuer, other than the requirement that the amount of money invested at any one time in commercial paper, bankers' acceptances and municipal obligations shall not exceed 20%.
- Endowment investment managers are limited to a maximum investment in any one issuer of no more than five percent of total investments.

At June 30, 2014 and 2013, the System had no investments in any one issuer that represent five percent or more 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 Commonwealth 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's 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 System's exposure to foreign currency risk derives from certain endowment investments of the University's pooled endowment fund. The University's investment policy allows fixed income managers to invest a portion of their portfolios in non-U.S. securities. Additionally, the investment policy allows various pooled fund managers to invest in accordance with the guidelines established in each individual fund's prospectus, which allows for investment in non-U.S. securities. The University's investments in the various pooled funds are denominated in U.S. dollars, with the exception of two private equity funds denominated in Euros. Endowment managers are permitted to use derivative instruments to limit foreign currency risk.

3. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, as of June 30, 2014 and 2013 are as follows (in thousands):

	2014	2013
Medicare, Medicaid and other third parties	$ 114,877	$ 110,568
Private pay	5,973	8,555
Pledges receivable	1,336	734
Total accounts receivable, net	$ 122,186	$ 119,857

Operating pledges totaling approximately $4.7 million are expected to be collected over the next seven years. In addition, capital pledges totaling approximately $4.2 million are expected to be collected over the next eight years. In accordance with GASB Statement No. 33, "*Accounting and Financial Reporting for Nonexchange Transactions,*" the System is required to record operating and capital pledges as revenue when all eligibility requirements have been met. For the years ended June 30, 2014 and 2013, the System recorded the discounted value of operating and capital pledges using a rate of two percent. Accordingly, at June 30, 2014, and 2013, respectively, the System recorded the discounted value of operating and capital pledges receivable of approximately $5.5 million and $3.3 million, including $4.2 million and $2.6 million in noncurrent – other assets, and $1.3 million and $734,000 in accounts receivable, net.

The System has recorded an allowance for uncollectible patient accounts receivable equal to 24.4% and 24.2% of patient accounts receivable as of June 30, 2014 and 2013, respectively. A summary of the changes in the allowance for uncollectible patient accounts receivable is as follows:

	2014	2013
Balance, beginning of year	$ 35,493	$ 35,684
Provision for bad debts	133,212	145,208
Receivables charged off, net of recoveries	(141,036)	(145,399)
Balance, end of year	$ 27,669	$ 35,493

4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2014 and capital asset activity for the year ended June 30, 2014 are summarized as follows (in thousands):

	Beginning Balance	Additions	Deletions	Ending Balance
Land	$ 25,338	$ -	$ -	$ 25,338
Non-depreciable land improvements	15,607	-	-	15,607
Depreciable land improvements	8,735	2	-	8,737
Buildings	729,039	5,291	-	734,330
Fixed equipment	20,204	1,953	-	22,157
Infrastructure	27,865	-	-	27,865
Equipment	235,075	25,264	10,886	249,453
Vehicles	934	-	-	934
Capitalized software	69,884	4,196	-	74,080
Artwork	1,673	128	-	1,801
Construction in process	4,044	22,565	3,842	22,767
Certificate of need	11,609	-	-	11,609
	1,150,007	59,399	14,728	1,194,678
Accumulated Depreciation:				
Depreciable land improvements	4,190	352	-	4,542
Buildings	152,202	16,950	-	169,152
Fixed equipment	9,359	1,795	-	11,154
Infrastructure	3,865	1,114	-	4,979
Equipment	151,266	25,463	10,630	166,099
Vehicles	791	64	-	855
Capitalized software	23,396	5,722	-	29,118
	345,069	51,460	10,630	385,899
Capital assets, net	$ 804,938	$ 7,939	$ 4,098	$ 808,779

Capital assets as of June 30, 2013 and capital asset activity for the year ended June 30, 2013 are summarized as follows (in thousands):

	Beginning Balance	Additions	Deletions	Ending Balance
Land	$ 23,577	$ 1,761	$ -	$ 25,338
Non-depreciable land improvements	15,607	-	-	15,607
Depreciable land improvements	8,735	-	-	8,735
Buildings	721,610	7,429	-	729,039
Fixed equipment	18,737	1,467	-	20,204
Infrastructure	27,865	-	-	27,865
Equipment	230,936	13,485	9,346	235,075
Vehicles	934	-	-	934
Capitalized software	61,040	8,844	-	69,884
Artwork	1,601	72	-	1,673
Construction in process	4,398	3,139	3,493	4,044
Certificate of need	11,609	-	-	11,609
	1,126,649	36,197	12,839	1,150,007
Accumulated Depreciation:				
Depreciable land improvements	3,860	330	-	4,190
Buildings	135,093	17,109	-	152,202
Fixed equipment	7,756	1,603	-	9,359
Infrastructure	2,750	1,115	-	3,865
Equipment	133,985	25,480	8,199	151,266
Vehicles	728	63	-	791
Capitalized software	18,499	4,897	-	23,396
	302,671	50,597	8,199	345,069
Capital assets, net	$ 823,978	$ (14,400)	$ 4,640	$ 804,938

At June 30, 2014, the System has construction projects in progress totaling approximately $48.5 million in scope. The estimated cost to complete these projects was approximately $23.6 million. Such construction is principally financed by System’s cash reserves and loans from the University.

Interest costs incurred during construction, net of related investment income, are capitalized. Total interest capitalized was $454,000 for 2014 and $17,000 for 2013.

During 2014 and 2013, the System utilized capital leases to acquire various items of equipment. The net book value for capitalized leased land, buildings and equipment is $68.3 million and $69.5 million at June 30, 2014 and 2013, respectively.

5. NOTES RECEIVABLE

Notes receivable at June 30, 2014 and 2013 are as follows (in thousands):

	2014	2013
Non-interest bearing, unsecured receivable from UK Parking and Transportation, payable $250,000 annually	$ -	$ 500
Non-interest bearing, unsecured receivable from UK College of Pharmacy	6,723	6,723
Non-interest bearing, unsecured receivable from UK College of Pharmacy	6,000	6,500
Non-interest bearing, unsecured receivable from UK College of Pharmacy	2,817	2,817
Interest bearing, 1.29%, line of credit from Coldstream Laboratories, Inc. through a loan to University of Kentucky Research Foundation	2,710	2,710
Notes receivable - other	1,636	1,652
Total	$ 19,886	$ 20,902
Current portion	$ 5,783	$ 5,973
Noncurrent portion	14,103	14,929
Total	$ 19,886	$ 20,902

6. OTHER ASSETS

Other assets at June 30, 2014 and 2013 are as follows (in thousands):

	2014	2013 (Restated - Note 1)
Amounts on deposit with trustee, primarily invested in U.S. government agencies	$ 757	$ 2
Noncurrent portion of prepaid expenses	473	702
Pledges receivable noncurrent	4,151	2,590
Total	$ 5,381	$ 3,294

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2014 and 2013 are summarized as follows (in thousands):

	2014	2013
Payable to vendors and contractors	$ 57,136	$ 34,299
Due to the University of Kentucky	3,481	3,338
Accrued expenses, including vacation leave	50,631	43,126
Total	$ 111,248	$ 80,763

8. LONG-TERM DEBT

Long-term debt as of June 30, 2014 and 2013 are summarized as follows (in thousands):

	2014					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
General Receipts Project Notes	$ 331,885	$ -	$ 10,875	$ 321,010	$ 11,390	$ 309,620
Due to the University of Kentucky and affiliates	32,290	537	2,999	29,828	3,022	26,806
Total	$ 364,175	$ 537	$ 13,874	$ 350,838	$ 14,412	$ 336,426

	2013					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
General Receipts Project Notes	$ 342,300	$ -	$ 10,415	$ 331,885	$ 10,875	$ 321,010
Due to the University of Kentucky and affiliates	28,978	4,680	1,368	32,290	2,999	29,291
Total	$ 371,278	$ 4,680	$ 11,783	$ 364,175	$ 13,874	$ 350,301

Principal maturities and interest on long-term debt for the next five years and in subsequent five-year periods as of June 30, 2014 are as follows (in thousands):

	Principal	Interest	Total
2015	$ 14,412	$ 16,070	$ 30,482
2016	16,152	15,475	31,627
2017	15,638	14,844	30,482
2018	19,239	14,152	33,391
2019	19,955	13,389	33,344
2020-2024	108,877	53,646	162,523
2025-2029	98,370	27,255	125,625
2030-2034	23,540	13,322	36,862
2035-2039	28,330	5,959	34,289
2040	6,325	181	6,506
Total	$ 350,838	$ 174,293	$ 525,131

Bond premiums, which are included in current and noncurrent accrued liabilities, are amortized over the life of the bond using the effective interest method.

The General Receipts Project Notes consist of bonds in the original amount of $366.3 million dated October 27, 2005 through November 24, 2009, which bear interest at 3.59% to 4.66%. The bonds are payable in annual installments through November 1, 2039. The System is required to make semi-annual deposits of varying amounts to the debt service funds held by the trustees. The bonds are secured by pledged revenues of the University, which include the net revenues of the System. On November 24, 2009, $100.6 million of the University of Kentucky General Receipts Bonds Series 2009 B were issued at a net interest cost of 3.59%.

These bonds were issued as Build America Bonds (BAB) as authorized under the American Recovery and Reinvestment Act of 2009. The System will receive an annual cash subsidy from the U.S. Treasury equal to 35% of the interest payable on the bonds. This subsidy, which was approximately $1.8 million during fiscal year 2014, is included in gifts and non-exchange grants in the statements of revenues, expenses and changes in net position. The subsidy payment is contingent on federal regulations and may be subject to change. On March 1, 2013, the President signed an executive order to reduce the budgetary authority in accounts subject to sequestration, As a result, the BAB subsidy was reduced to approximately 33% and 32% in 2014 and 2013, respectively.

On July 30, 2010, the System entered into an unsecured internal loan agreement with the University to acquire funding for construction of a suite of operating rooms in the newly constructed patient care facility. Funds will be transferred to the construction project as needed and will be repaid over a ten year period. Interest shall be charged based on the historical performance of the two-year U.S. Treasury note plus (1.0%). The total effective rate was 1.24% for interest payments in 2014 and 1.30% in 2013. The annual interest rate will be determined March 1 and be effective for the following fiscal year.

9. CAPITAL LEASE OBLIGATIONS

Capital lease obligations as of June 30, 2014 and 2013 are summarized as follows (in thousands):

	2014					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
Leases	$ 93,533	$ 112	$ 21,211	$ 72,434	$ 16,647	$ 55,787

	2013					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
Leases	$ 88,188	$ 25,194	$ 19,849	$ 93,533	$ 21,120	$ 72,413

Scheduled payments of capital lease obligations are as follows (in thousands):

Years ended June 30	
2015	$ 18,721
2016	13,469
2017	11,403
2018	8,306
2019	4,916
2020 and later years	27,497
Total	84,312
Less amount representing interest	(11,878)
Present value of net minimum lease payments	$ 72,434

Capital lease obligations are at varying rates of imputed interest of 0.95% to 4.45%.

10. LONG-TERM LIABILITIES – OTHER

Other long-term liabilities as of June 30, 2014 and 2013 are summarized as follows (in thousands):

	2014			
	Beginning Balance	Additions	Reductions	Ending Balance
Refundable deposits	$ 11	$ 6	$ -	$ 17
Unearned compensation	497	325	-	822
Noncurrent unamortized bond premium	5,726	-	1,278	4,448
Long-term liabilities - other	$ 6,234	$ 331	$ 1,278	$ 5,287

	2013			
	Beginning Balance	Additions	Reductions	Ending Balance
Refundable deposits	$ 2,598	$ 27	$ 2,614	$ 11
Unearned compensation	228	269	-	497
Noncurrent unamortized bond premium	6,174	-	448	5,726
Long-term liabilities - other	$ 9,000	$ 296	$ 3,062	$ 6,234

11. DESIGNATIONS OF UNRESTRICTED NET POSITION

Unrestricted net position is designated for specific purposes by action of the University's Board of Trustees or management or may otherwise be limited by contractual obligations. Commitments for the use of unrestricted net position at June 30, 2014 and 2013 are as follows (in thousands):

	2014	2013
Working capital requirements	$ 140,344	$ 100,154
Future capital expenditures	260,576	223,023
Total	$ 400,920	$ 323,177

12. INVESTMENT INCOME (LOSS)

Components of investment income (loss) for the years ended June 30, 2014 and 2013 are as follows (in thousands):

	2014	2013
Interest and dividends earned on endowment investments	$ 3,355	$ 3,822
Realized and unrealized gains and (losses) on endowment investments	32,982	20,529
Interest and dividends on cash and non-endowment investments	825	1,504
Realized and unrealized gains and (losses) on non-endowment investments	(18)	(14)
Total	$ 37,144	$ 25,839

13. PROGRAM FOR INDIGENT CARE AND CHARITY CARE

The System is reimbursed for uncompensated care, including indigent care, by the Commonwealth based upon available Disproportionate Share System funds. The amounts are included in net patient service revenues and summarized below (in thousands):

	2014	2013
Revenue from the Commonwealth of Kentucky	$ 26,487	$ 27,170
2.5% tax paid by the System on patient cash receipts	(11,756)	(11,755)
Matching contribution paid by the System	(7,933)	(7,458)
Net amount received, included in net patient service revenues	$ 6,798	$ 7,957

The amount of charges forgone for services and supplies furnished under the System's charity care policy aggregated to approximately $108.4 million and $187.3 million in 2014 and 2013, respectively. As a result of health care reform, the System is seeing a reduction in the amount of charity care as more Kentuckian's are enrolled into Medicaid.

14. PLEDGED REVENUES

The University has substantially pledged all of the unrestricted operating and nonoperating revenues, including the System revenues, to repay the General Receipts bonds and notes issued during 2005 to 2014. Only the General Receipts Series 2005 A Notes, General Receipts Series 2007 A Notes, and General Receipts Series 2009 B Bonds are reflected as the System debt. Proceeds from the notes provided funding for the construction of the new patient care facility. The notes are payable from unrestricted operating and nonoperating revenues and are payable through 2039. Annual principal and interest payments on notes are expected to require less than three percent of pledged revenues. The total principal and interest remaining to be paid on the notes is $493.4 million and $520.5 million in 2014 and 2013, respectively. Principal and interest paid for each of the years ended June 30, 2014 and 2013 was $27.1 million.

15. PENSION PLANS

Regular full-time employees of the System are participants in the University of Kentucky Retirement Plan, a defined contribution plan. System employees participate in one of the following three groups of the University of Kentucky Retirement Plan:

Group I	Established July 1, 1964, for faculty and certain administrative officials.
Group II	Established July 1, 1971, for staff members in the clerical, technical and service categories.
Group III	Established July 1, 1972, for staff members in the managerial, professional and scientific categories.

Participation in these groups of the University of Kentucky Retirement Plan is mandatory for all regular full-time employees age 30 and older. Participation is voluntary until age 30. The System contributes 10 percent and each employee contributes five percent of eligible compensation. All payments are vested immediately for employees hired prior to January 1, 2010. For employees hired after January 1, 2010, employer contributions are vested after three years.

The University has authorized two retirement plan carriers, as follows:

Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF)
Fidelity Investments Institutional Services Company

In addition to retirement benefits provided from the group retirement plan, the University provides supplemental retirement income benefits to certain eligible employees of the University.

The total contributions charged to operations for the various retirement plans were approximately $23.6 million and $21.2 million for the years ended June 30, 2014 and 2013, respectively. Employees contributed $11.8 million and $10.6 million during 2014 and 2013, respectively. The payroll for employees covered by the retirement plans was $236.3 million and $211.9 million for 2014 and 2013, respectively.

16. HEALTH INSURANCE BENEFITS FOR RETIREES

The University administers a single-employer defined-benefit healthcare plan including medical and prescription drug benefits. The plan provides lifetime healthcare insurance benefits for eligible retirees and their surviving spouses. Human Resources Policies and Procedures define retiree health benefits and can be amended by the President of the University as delegated by the University's Board of Trustees.

The University provides a pre-65 credit of up to 90 percent of the "true retiree" cost of the least expensive pre-65 medical plan. For post-65 benefits, the University provides a credit equal to 90 percent of the "true retiree" cost of the post-65 medical plan. However, retirees must pay the greater of $25 per month or 10 percent of total plan cost.

The University has established a trust fund to segregate plan assets, and currently plans to contribute amounts to the trust fund sufficient to fully fund the annual required contribution, an amount actuarially determined in accordance with the parameters of GASB Statement 45.

As an organizational unit of the University, the System has recognized its share of the contribution in employee benefit costs and has no additional liability for this benefit at June 30, 2014.

17. RISK MANAGEMENT

The University, of which the System is an organizational unit, is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims, or (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance, participation in insurance risk retention groups or self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and most other causes of loss between $250,000 and $1.0 million per occurrence. Losses in excess of $1.0 million are insured by commercial carriers up to $1.25 billion per occurrence, buildings at replacement cost and contents on an actual cash value basis. As a state agency, the University is vested with Sovereign Immunity and is subject to the provisions of the Board of Claims Act, under which the University's liability for certain negligence claims is limited to $200,000 for any one person or $350,000 for all persons damaged by a single act of negligence. Claims against educators' errors and omissions and wrongful acts are insured through a reciprocal 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.

The University and its agents are insured against medical malpractice by a combination of Sovereign Immunity, self-insurance, commercial liability insurance, and an excess coverage fund established by the Commonwealth of Kentucky. An actuarial valuation is performed to determine the self insurance funding requirements and the fund liability, which has been discounted using an interest rate of three and a half percent. The malpractice liability at June 30, 2014, is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be recorded if it is probable that a liability has occurred and the amount of loss can be reasonably estimated. The liability includes an estimate for claims that have been incurred but not reported at June 30, 2014. All assets and liabilities related to medical malpractice are recorded in the financial records of the University and, accordingly, no assets or liabilities related to medical malpractice are recorded on the System's financial statements. However, the System does fund its required share of the actuarially determined medical malpractice expense.

The University is self-insured for the long-term disability income program and has established a 501(c)(9) trust for purposes of paying claims and establishing necessary reserves. The University currently plans to contribute amounts to the trust fund sufficient to fully fund the annual required contribution of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. As an organizational unit of the University, the System has recognized its share of the contribution in employee benefit costs and has no additional liability for this benefit at June 30, 2014.

The University also self-insures certain employee benefits, including health insurance, worker's compensation and unemployment claims. The University has recorded an estimate for asserted claims at June 30, 2014.

18. TRANSACTIONS WITH RELATED PARTIES

Due to the nature of the relationship of the System with the University, the System has substantial transactions with the University, including purchases of various supplies and services. Additionally, the University and its affiliates provide certain administrative support functions to the System. The System paid approximately $9.2 million and $11.8 million respectively in 2014 and 2013 to the University as reimbursement for various educational and support functions. The System also recognized income from the University for providing medical services to employees under a capitation health plan. During 2014 and 2013, the System received payments of approximately $29.2 million and $28.7 million, respectively, from the University. In December 2011, the University of Kentucky Board of Trustees authorized the transfer of up to $4.0 million to UKRF to be used for investment in Coldstream Laboratories, Inc. (CLI) to fund operations and capital improvement. Interest began to accumulate upon initial transfer of funds. In addition, the System advanced $3.0 million to UKRF to be used as a line of credit to CLI for working capital, with interest adjusted annually on March 1 to the two-year U.S. Treasury rate plus one percent (1.38 percent at December 31, 2013). Interest began to accumulate upon initial transfer of funds. Payment term on the line of credit is five years from the date of the final cash transfer. As of June 30, 2014, $2.7 million had been transferred to CLI on the line of credit and $4.0 million had been transferred for operations and capital improvements. The System provided the funds to UKRF for the investment and line of credit are included in the net due to the University of Kentucky and affiliates.

19. RECLASSIFICATIONS

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

20. SUBSEQUENT EVENT

On July 26, 2014, the University issued $88.1 million in General Receipts Refunding Bonds Series 2014 D. Of these proceeds, $66.9 million were used to partially refund General Receipts Series 2005 A Notes, which funded the construction of the new Patient Care Facility. The bond proceeds, and the $10.4 million in premium (net cost of issuance) paid by underwriters combine to provide the total amount of $77.4 million needed to call the bonds. The debt service savings for fiscal year 2014-15 will be approximately $808,000 and a total of $9.0 million through fiscal year 2025-26. The debt service payments on the new bonds are scheduled semi-annually at amounts that range from $2.6 million to $8.3 million with interest rates that range from three percent to 5.25%.

University of Kentucky

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