UNIVERSITY OF

KENTUCKY®

UK HealthCare Hospital System

2015 Financial Statements

UK HealthCare Hospital System
An Organizational Unit of the University of Kentucky
Financial Statements
Years Ended June 30, 2015 and 2014

CONTENTS PAGE

BKD LLP
CPAs & Advisors
600 N. Hurstbourne Parkway, Suite 350 // P.O. Box 22127 // Louisville, KY 40252-0127
502.581.0435 // fax 502.581.0723 // bkd.com

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2015 and 2014, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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, 2015 and 2014, 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.

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 2, 2015

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, 2015 and 2014. 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 and remains a top 25 academic health system among the members of the UHC. 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 826 licensed beds with an average daily census of 698 patients. On a monthly basis, the system provides over 1,257 inpatient surgeries, 1,343 outpatient surgeries, 31,649 radiology procedures, 8,450 emergency department visits and 111,307 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 $1.71 billion and liabilities of $709.2 million. Net position, which represents the System's residual interest in assets after liabilities are deducted, was $1.01 billion or 59.3% of total assets. For the fiscal year ended June 30, 2015, the System reported net income before other revenues, expenses, gains and losses of $193.4 million, generating a margin of 14.5%.

Financial results for fiscal year 2015 exceeded prior year revenues with net inpatient revenues, including the provision for doubtful accounts, increasing approximately $89.0 million or 13.3% over the prior fiscal year and net outpatient revenues, including the provision for doubtful accounts, increasing $110.1 million or 30.0% 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 $341.6 million or 24.9%. This increase is due to increases in cash and cash equivalents of $320.0 million, capital assets, net of $18.0 million, accounts receivable of $15.7 million, inventories of $6.7 million, and long-term investments of $2.8 million. This increase was offset by decreases in notes receivable of $12.8 million, estimated third-party receivables of $6.5 million, other assets of $2.3 million, and accrued interest receivable of $6,000.
- Deferred outflows of resources increased $12.4 million, which represents the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt. The System refunded General Receipts 2005 Notes Series A and General Receipts 2007 Notes Series A and B during the fiscal year.
- Total liabilities increased $161.9 million or 29.60%, as a result of increases of $110.1 million in long-term debt, $21.2 million in unearned revenue, $44.1 million in accounts payable, accrued liabilities and other long-term liabilities, and $2.1 million in estimated third party payer settlements. The increase in long-term debt was due to the issuance of $306.3 million in new bonds offset by payments on outstanding debt and $180.3 million in refunded debt, and a $4.1 million net decrease in the amount due to the University of Kentucky and affiliates. These increases were offset by a net decrease of $15.5 million in capital lease obligations.
- Total net position increased $192.0 million or 23.4%, primarily due to the current year net income.
- Operating revenues increased $214.1 million or 19.2%, primarily due to an increase in net patient revenue of $199.1 million.
- Operating expenses increased $116.3 million or 11.5%, with all categories contributing to the increase. The most significant change was in supplies and personnel costs due to increased patient activity.
- The net nonoperating revenues decrease of $35.4 million primarily resulted from a $32.3 million decrease in investment income and a $3.7 million decrease in gifts. These decreases were offset by a $1.4 million decrease in interest expense and an increase of $187,000 in gain of disposal of capital assets.

Operating Statistics

The following table presents utilization statistics for the System for fiscal years ended 2015, 2014 and 2013:

Discharges:	2015	2014	2013
Medicare	12,591	11,888	11,322
Medicaid	14,286	11,035	9,911
Commercial/Blue Cross	9,519	9,560	10,278
Patient/Charity	647	2,697	4,000
Total discharges	37,043	35,180	35,511
Average daily census	698	627	577
Average length of stay	6.78	6.50	5.93
Outpatient visits:			
Hospital clinics	479,782	428,582	368,223
Emergency visits	101,395	91,146	88,752
Total visits	581,177	519,728	456,975

<u>2015.</u> Total discharges increased by 1,863 or 5.3% compared to the prior fiscal year. The increase occurred primarily due to increases in Medicaid discharges of 3,251 and Medicare of 703. These increases were offset by decreases in Patient/Charity discharges of 2,050 and Commercial/Blue Cross discharges of 41. Overall the Diagnosis-Related Group (DRG) case mix index increased to 1.9270 from 1.9055 and the average length of stay increased by 0.28 days to 6.78 days. The case mix for Chandler was at 2.1089 while Good Samaritan was at 1.3618. Total outpatient visits increased by 61,449 or 11.8% 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 (GASB) 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, and net position (equity) of the System as of June 30, 2015, with comparative information as of June 30, 2014. 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, and total liabilities, 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, and liabilities 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, and net position at June 30, 2015, 2014 and 2013 follows:

Condensed Statements of Net Position (in thousands)

	2015	2014	2013
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES			
Current assets	$ 445,260	$ 263,486	$ 197,394
Capital asset, net	826,805	808,779	804,938
Other noncurrent assets	438,558	296,804	257,664
Deferred outflows of resources	12,368	-	-
Total assets and deferred outflows of resources	1,722,991	1,369,069	1,259,996
LIABILITIES			
Current liabilities	180,618	149,852	131,052
Noncurrent liabilities	528,623	397,500	428,948
Total liabilities	709,241	547,352	560,000
NET POSITION			
Net investment in capital assets	437,489	410,348	373,346
Nonexpendable other	119	118	117
Restricted expendable	10,538	10,331	14,965
Unrestricted	565,604	400,920	311,568
Total net position	$ 1,013,750	$ 821,717	$ 699,996

Assets. As of June 30, 2015, the System's total assets amounted to approximately $1.71 billion. Capital assets, net of depreciation, of $826.8 million or 48.3% represented the System's largest asset. Long-term investments of $271.7 million or 15.9% of total assets were the System's second largest asset. Accounts receivable, primarily patient-related, of $137.8 million or 8.1% represents another significant asset of the System. Cash and cash equivalents totaled $431.6 million or 25.2% of total assets.

Total assets increased by $341.6 million during the year ended June 30, 2015. The increase was the result of several factors: unrestricted and restricted cash increased $320.0 million primarily from operating activities of $263.7 million, noncapital financial activities of $15.0 million, cash from capital and related financing activities of $38.5 million and cash from investing activities of $2.8 million due to the endowment posting a gain of 1.5%. Capital assets, net increased $18.0 million due to construction projects, purchases of capital equipment, and software development. In addition, accounts receivable, net, increased $15.7 million, inventories increased $6.7 million, long-term investments increased $2.8 million, notes receivable decreased $12.8 million, estimated third-party payer settlements receivable decreased by $6.5 million and other assets decreased $2.3 million.

Deferred Outflows of Resources. Deferred outflows of resources increased $12.4 million, which represents the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt. The System refunded General Receipts 2005 Notes Series A, and General Receipts 2007 Notes Series A and B during the fiscal year.

Liabilities. As of June 30, 2015, the System's liabilities totaled approximately $709.2 million. Long-term debt (current and non-current) which consists of general receipts project notes and note payable to the University, comprised the largest liability of $460.9 million or 65.0% of total liabilities. Capital lease obligations totaled $56.9 million or 8.0% of liabilities. Current accounts payable and accrued expenses represented approximately $122.6 million or 17.3% of liabilities. Long-term liabilities, other, primarily unamortized bond premium, totaled $38.0 million or 5.4% of liabilities. Total liabilities increased $161.9 million primarily due to increases in long-term debt of $110.1 million, long-term liabilities, other, $32.7 million and in unearned revenue of $21.2 million. These were offset by a decrease in capital lease obligations of $15.5 million,

Net Position. Net position at June 30, 2015 totaled approximately $1.01 billion, or 59.3% of total assets. Net investment in capital assets totaled $437.5 million or 43.2% of total net position. Restricted net position totaled approximately $10.7 million or 1.1% of total net position. Unrestricted net position accounted for $565.6 million or 55.8% of total net position. Total net position increased $192.0 million or 23.4%.

Restricted net position is subject to externally imposed restrictions governing its 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.

2014 Versus 2013. When comparing the fiscal year ended June 30, 2014 to the year ended June 30, 2013:

- Total assets increased by $109.1 million during the year ended June 30, 2015. 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.
- 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.
- Total net position increased $121.7 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, 2015, with comparative information for the year ended June 30, 2014. 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.

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

	2015	2014	2013
OPERATING REVENUES			
Net patient service revenues	$ 1,238,392	$ 1,039,264	$ 926,811
Sales and services	51,476	39,833	24,639
Management contract revenue	39,265	35,910	-
Total operating revenues	1,329,133	1,115,007	951,450
OPERATING EXPENSES			
Salaries and wages	343,872	306,265	279,001
Fringe benefits	98,101	87,533	79,803
Supplies	287,184	240,898	210,363
Purchased services	182,656	168,654	166,597
Other expenses	129,015	125,414	99,183
Depreciation	53,167	51,460	51,261
Management contract expenses	35,910	33,348	-
Total operating expenses	1,129,905	1,013,572	886,208
NET INCOME FROM CONTINUING OPERATIONS	199,228	101,435	65,242
NONOPERATING REVENUES (EXPENSES)			
State appropriations	1,053	1,053	1,053
Gifts and non-exchange grants	4,128	7,806	6,653
Investment income	4,837	37,144	25,839
Interest expense	(17,099)	(18,541)	(19,779)
Gain (loss) on disposal of capital assets	497	310	-
Other	721	1,752	584
Net nonoperating revenues (expenses)	(5,863)	29,524	14,350
Net income before other revenues, expenses, gains or losses	193,365	130,959	79,592
Transfers (to) the University of Kentucky for noncapital purposes	(3,142)	(11,128)	(17,373)
Transfers from the University of Kentucky for capital purposes	1,810	1,890	1,675
Total increase in net position	192,033	121,721	63,894
Net position, beginning of year	821,717	699,996	636,102
Net position, end of year	$ 1,013,750	$ 821,717	$ 699,996

Operating Revenues:

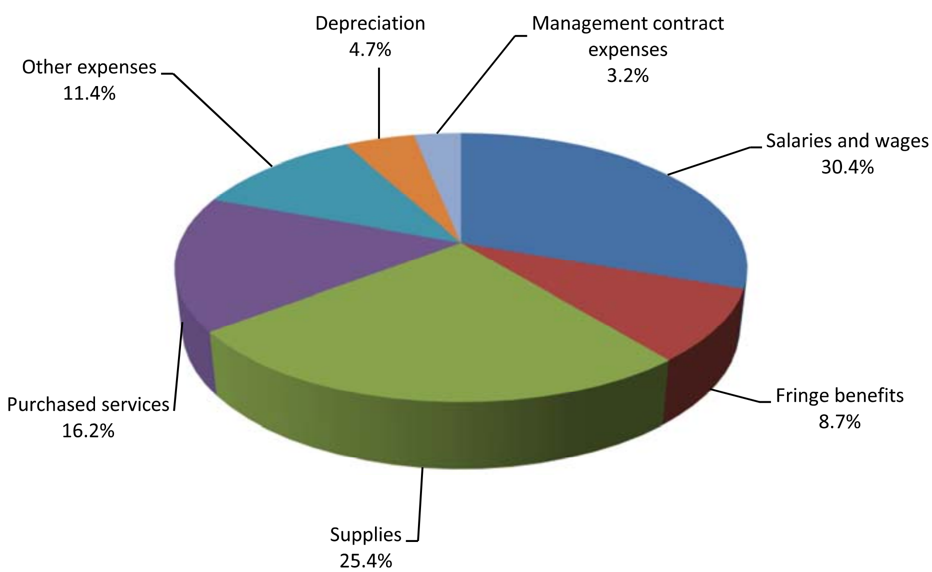
Total operating revenues were approximately $1.33 billion for the year ended June 30, 2015, an increase of $214.1 million or 19.2% over fiscal year 2014. The most significant source of operating revenue for the System was net patient service revenues of $1.24 billion, an increase of $199.1 million or 19.2% in fiscal year 2015 over 2014.

Inpatient net revenue, including bad debt, increased $89.0 million over prior year. Rate was the primary driver of the increase which can be partially attributed to a 1.1% increase in acuity, with case mix index closing the year at 1.9270. In addition, a favorable payer mix change driven by Medicaid expansion saw self-pay inpatient case volume decrease by 2,050 over prior year, while Medicaid grew by 3,251 cases.

Outpatient net revenue, including bad debt, increased by $110.1 million or 30.0% over prior year. Outpatient activity increased by 11.8% with hospital clinic visits increasing 51,200 over prior year and an increase of 10,249 in emergency room visits.

Bad debt provision decreased by $57.4 million or 43.1% 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.

TOTAL OPERATING EXPENSES



Operating Expenses:

Total operating expenses, including $53.2 million of depreciation, were $1.13 billion, an increase of $116.3 million or 11.5% over the prior year.

Salaries and wages increased by $37.6 million over the prior fiscal year. The increase in salary and wages was driven by an FTE increase of 529, an 8.9% 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 $10.6 million or 12.1%. Management contract expenses related to Eastern State Hospital were $35.9 million, an increase of $2.6 million.

Supplies expenses increased by $46.3 million or 19.2% primarily due to increases in overall patient activity. Other expenses increased by $3.6 million or 2.9%, purchased services increased $14.0 million or 8.3%, and depreciation expense increased $1.7 million or 3.3%.

Nonoperating Revenues (Expenses):

Total nonoperating expenses were ($5.9) million in fiscal year 2015 compared to net nonoperating revenues, net of expenses, of $29.5 million during the prior fiscal year. This decrease is primarily due to a net investment gain of $4.8 million in fiscal year 2015 compared to a gain of $37.1 million in the prior year. The endowment pool posted a total gain of 1.6% for fiscal 2015 versus a total gain of 15.5% in the prior year.

2014 Versus 2013. Total operating revenues were $1.12 billion for the fiscal year ended June 30, 2014, an increase of $163.6 million over the year ended June 30, 2013. Essentially all of the increase in operating revenues was due to increased net patient service revenues and the new management contract revenue.

Operating expenses totaled $1.01 billion, an increase of $127.4 million over 2013. The increase was caused primarily by higher costs for personnel, supplies and depreciation.

Nonoperating revenues, net of expenses, amounted to $29.5 million in fiscal year 2014 compared to net nonoperating revenues, net of expenses, of $14.4 million in the prior 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.

Statement of Cash Flows

The Statement of Cash Flows details how cash has increased or decreased during the year ended June 30, 2015, with comparative financial information for the year ended June 30, 2014. 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)

	2015	2014	2013
CASH PROVIDED (USED) BY:			
Operating activities	$ 263,731	$ 161,210	$ 144,657
Noncapital financing activities	14,979	(2,264)	(55,791)
Capital and related financing activities	38,487	(102,791)	(54,696)
Investing activities	2,774	367	3,666
Net increase (decrease) in cash and cash equivalents	319,971	56,522	37,836
Cash and cash equivalents, beginning of year	111,668	55,146	17,310
Cash and cash equivalents, end of year	$ 431,639	$ 111,668	$ 55,146

2015. The major sources of cash included in operating activities was patient service revenues of $1.25 billion, sales and services of $51.5 million and management contract services of $44.4 million. Cash payments for operating activities were $606.9 million to suppliers, $436.2 million to employees for salaries, wages and fringe benefits and payments on management contract services of $38.6 million.

Cash provided by noncapital financing consists of payments on loan from University departmental units of $12.8 million, gifts of $5.5 million, and state appropriations of $1.1 million offset by an outflow of cash due to transfers to the University of Kentucky for noncapital purposes of $4.3 million.

Capital and related financing activities included proceeds from long-term obligations of $346.3 million and proceeds from the sale of capital assets of $4.4 million offset by payments to refunding bond agents of $196.3 million, principal and interest payments on long-term obligations of $49.4 million, purchases of capital assets of $66.9 million and other capital and financing payments of $244,000.

Investing activities included proceeds from sales and maturities of investments of $81.4 million and interest and dividends of $2.3 million. Cash of $80.9 million was used to purchase investments.

2014 Versus 2013. Cash balances increased when comparing fiscal year 2014 versus fiscal year 2013 with a net increase in cash of approximately $56.5 million, primarily due to an increase in patient service revenues and a reduction in noncapital financing activities offset by decreased capital lease proceeds.

Key Ratios

The following table shows key liquidity and capital ratios for fiscal years 2015, 2014, and 2013:

	2015	2014	2013
Days cash on hand	146	42	24
Days of revenue in accounts receivable	41	43	47
Debt service coverage (times)	5.4	3.6	2.7

Days cash on hand increased to 146 days in fiscal year 2015 from 42 days in fiscal year 2014 due to the increase in cash balance of $320.0 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. In addition, the System has access to working capital from the University and quasi-endowment investments of $271.7 million.

The days of revenue in accounts receivable measures the average number of days it takes to collect accounts receivable. In fiscal year 2015, days in accounts receivable were 41 compared to 43 days in fiscal year 2014.

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 2015 is 5.4 versus 3.6 in fiscal year 2014 due to the increase in net position in fiscal year 2015 compared to fiscal year 2014.

Capital Asset and Debt Administration

Capital Assets. Capital assets, net of accumulated depreciation, totaled approximately $826.8 million at June 30, 2015, a net increase of $18.0 million over the prior year end. Significant changes in capital assets during fiscal 2014-2015 included (in millions):

Land, buildings and structures, net additions	$ 35.3
Equipment and vehicles, net additions	10.8
Capitalized software additions	5.5
Artwork	-
Construction in process, net additions	2.7
Increase in accumulated depreciation, net	(36.3)
Total	$ 18.0

Debt. At year-end, the System had $435.2 million in general receipts project notes outstanding and a $25.7 million loan due to the University; $15.0 million is included in current liabilities with the remainder long term. In addition, the System had $56.9 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 2015. 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, Touchworks, for outpatient care across the enterprise. Approximately 90% of UK HealthCare clinic sites are operational as of July 2015, with the project slated for completion in fiscal year 2016 (Fall 2015). Final clinics primarily include off site locations, Ophthalmology, clinical research and highly complex conditions such as Transplant.
- 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 the Affordable Care Act, 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 and March of 2015, UK HealthCare received board approval to build-out additional infrastructure and patient capacity within its facilities. At an estimated cost of $225.0 million dollars, the project includes funding for two new patient floors, Kentucky Children's Hospital facilities including a new NICU and outpatient facilities, increased elevator capacity, a new kitchen and cafeteria, surgical and laboratory facilities. The investment will create incremental state of the art bed capacity for continued future clinical growth and quality outcomes. Construction on a portion of the facilities has begun and detailed planning efforts around the project staging and timeline are underway for the remaining portions of the project. Once the two patient floors are complete UK HealthCare's licensed bed capacity will increase to 945 beds.
- A new central pharmacy opened within Pavilion A in the fall of 2014, which has enabled cost savings associated with inventory on hand, compounding and other operating efficiencies. In December 2014, UK Healthcare opened the 8th Floor of the pavilion to cardiovascular patients, providing incremental patient bed and ICU capacity. A new observation unit also opened within the pavilion in January 2015, which is helping 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, 2015 AND 2014

	2015	2014
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
Current Assets		
Cash and cash equivalents	$ 272,314	$ 103,253
Accounts receivable (less allowance for doubtful accounts of $43,014 in 2015 and $27,669 in 2014)	137,848	122,186
Inventories and other assets	32,431	25,768
Accrued interest receivable	-	6
Estimated third-party payer settlements	-	6,490
Notes receivable	2,667	5,783
Total current assets	445,260	263,486
Noncurrent Assets		
Restricted cash and cash equivalents	159,325	8,415
Long-term investments	271,708	268,905
Capital assets, net	826,805	808,779
Notes receivable	4,425	14,103
Other assets	3,100	5,381
Total noncurrent assets	1,265,363	1,105,583
Total assets	1,710,623	1,369,069
Deferred Outflows of Resources	12,368	-
Total assets and deferred outflows of resources	1,722,991	1,369,069
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	122,648	111,248
Unearned revenue	28,707	7,545
Estimated third-party payer settlements	2,073	-
Long-term debt - current portion	15,020	14,412
Capital lease obligations - current portion	12,170	16,647
Total current liabilities	180,618	149,852
Noncurrent Liabilities		
Long-term liabilities - other	38,009	5,287
Long-term liabilities - debt	445,885	336,426
Capital lease obligations	44,729	55,787
Total noncurrent liabilities	528,623	397,500
Total liabilities	709,241	547,352
NET POSITION		
Net investment in capital assets	437,489	410,348
Restricted		
Nonexpendable other	119	118
Expendable		
Capital projects	3,154	3,404
Other	7,384	6,927
Total restricted expendable	10,538	10,331
Total restricted	10,657	10,449
Unrestricted	565,604	400,920
Total net position	$ 1,013,750	$ 821,717

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, 2015 AND 2014

	2015	2014
OPERATING REVENUES		
Net patient service revenues, less provision for doubtful accounts of $75,846 in 2015 and $133,212 in 2014	$ 1,238,392	$ 1,039,264
Sales and services	51,476	39,833
Management contract revenue	39,265	35,910
Total operating revenues	1,329,133	1,115,007
OPERATING EXPENSES		
Salaries and wages	343,872	306,265
Fringe benefits	98,101	87,533
Supplies	287,184	240,898
Purchased services	182,656	168,654
Other expenses	129,015	125,414
Depreciation	53,167	51,460
Management contract expenses	35,910	33,348
Total operating expenses	1,129,905	1,013,572
Net income from continuing operations	199,228	101,435
NONOPERATING REVENUES (EXPENSES)		
State appropriations	1,053	1,053
Gifts and non-exchange grants	4,128	7,806
Investment income (loss)	4,837	37,144
Interest expense	(17,099)	(18,541)
Gain (loss) on disposal of capital assets	497	310
Other	721	1,752
Net nonoperating revenues (expenses)	(5,863)	29,524
Net income before other revenues, expenses, gains or losses	193,365	130,959
Transfers (to) the University of Kentucky for noncapital purposes	(3,142)	(11,128)
Transfers (to) from the University of Kentucky for capital purposes	1,810	1,890
Total other revenues (expenses)	(1,332)	(9,238)
INCREASE IN NET POSITION	192,033	121,721
NET POSITION, beginning of year	821,717	699,996
NET POSITION, end of year	$ 1,013,750	$ 821,717

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, 2015 AND 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net patient service revenues	$ 1,248,616	$ 1,026,615
Sales and services	51,476	39,833
Management contract services	44,371	35,461
Payments to vendors and contractors	(606,885)	(522,876)
Salaries, wages and fringe benefits	(436,241)	(389,954)
Payments on management contract services	(38,635)	(28,288)
Other receipts (payments)	1,029	419
Net cash provided (used) by operating activities	263,731	161,210
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	1,053	1,053
Gifts	5,457	6,244
Payments on loans from University of Kentucky departmental units	12,757	1,567
Transfers from (to) the University of Kentucky for noncapital purposes	(4,288)	(11,128)
Net cash provided (used) by noncapital financing activities	14,979	(2,264)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets	4,361	-
Purchases of capital assets	(66,910)	(49,843)
Payments to refunding bond agents	(196,331)	-
Principal payments-capital leases and long-term obligations	(32,611)	(34,900)
Interest payments-capital leases and long-term obligations	(16,764)	(19,168)
Proceeds from long-term obligations	346,331	-
Other capital and related financing payments	(244)	-
Transfers from (to) the University of Kentucky for capital purposes	655	1,120
Net cash provided (used) by capital and related financing activities	38,487	(102,791)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	81,416	167,334
Purchase of investments	(80,918)	(171,151)
Interest and dividends on investments	2,276	4,184
Net cash provided (used) by investing activities	2,774	367
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	319,971	56,522
CASH AND CASH EQUIVALENTS, beginning of year	111,668	55,146
CASH AND CASH EQUIVALENTS, end of year	$ 431,639	$ 111,668
Reconciliation of net income from continuing operations to net cash provided by operating activities:		
Net income from continuing operations	$ 199,228	$ 101,435
Adjustments to reconcile net income from continuing operations to net cash provided (used) by operating activities:		
Depreciation	53,167	51,460
Write off of principal note/lease receivable	778	735
Provision for doubtful accounts	(75,846)	(133,212)
Change in assets and liabilities:		
Accounts receivable	60,184	130,883
Inventories and other	(6,663)	(2,795)
Estimated third-party payer settlements receivable and payable	8,563	(14,857)
Other assets	(541)	(390)
Accounts payable and accrued liabilities	3,699	27,334
Unearned revenue	21,162	617
Net cash provided by operating activities	$ 263,731	$ 161,210
NON CASH TRANSACTIONS:		
Transfer of capital assets from (to) UK	$ 1,155	$ 770
Capital lease additions (reductions)	$ 1,365	$ (74)
Capital asset additions in accounts payable	$ 6,240	$ 4,514
Capitalized interest, net of investment income	$ 865	$ 454
Amortized bond premium	$ 5,543	$ 1,187

See notes to financial statements.

UK HEALTHCARE HOSPITAL SYSTEM
AN ORGANIZATIONAL UNIT OF THE UNIVERSITY OF KENTUCKY
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, 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 endowments are managed in a consolidated investment pool which consists of more than 2,000 named funds. All contributing endowments participate in the income and appreciation of the pool on a per unit basis commensurate with their contribution to the pool. New endowments purchase units in the pool at the current 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.

Effective for fiscal year 2015 and thereafter the University has established a "hybrid" spending policy, which includes both the market value of the endowment and the current level of inflation in determining spending each year. Annual spending 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. For fiscal year 2014, spending was based on four percent of the average endowment market value for the preceding 60 months.

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

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

For each of the years ended June 30, 2015 and 2014, 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 was \$8.6 million and \$8.1 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 a currently active project, net of interest earned on investments acquired with the proceeds of the borrowing. The System also capitalizes interest costs as a component of construction in progress on projects funded by unrestricted funds based on the interest costs of borrowings no longer associated with a specific project. The calculation is based on a project's average expenditures times the weighted average interest rate borrowings.

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.

Deferred Outflows of Resources. A deferred outflow of resources is a loss in net position by the System that is applicable to a future reporting period. Deferred outflows of resources are reported in the statement of net position, but are not recognized in the financial statements as expense until in the related period. Deferred outflows of resources of $12.4 million as of June 30, 2015, consisted of the unamortized difference between the reacquisition price and the net carrying amount of the refunded debt. The System issued General Receipts 2014 Bonds Series D to refund General Receipts 2005 Notes Series A which was originally issued to fund the construction of the Patient Care Facility. General Receipts Notes 2007 Series A and B originally issued to fund construction of the Patient Care Facility were refunded by the by the General Receipts 2015 Bond Series B.

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, 2015 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 28% and 27%, respectively, of the System's net patient service revenues before the provision for doubtful accounts for the year ended June 30, 2015 and approximately 25% and 24%, respectively for the year ended June 30, 2014. 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 $40.1 million, and $1.9 million, for ESH and CKRC respectively. The System also 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. 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 2015, the System was in the fourth year under the Medicare programs and recorded $1.1 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 2014, the System was in the third year of the programs and recorded $1.7 million.

In fiscal year 2015, the System received no revenue under the Medicaid program as their program ended in fiscal year 2014. In fiscal year 2014, the System recorded $564,000 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, 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.

Recent Accounting Pronouncements. As of June 30, 2015, the GASB has issued the following applicable statements not yet implemented by the System.

- GASB Statement No. 72 *Fair Value Measurement and Application,* issued March 2015. The provisions of this Statement are effective for fiscal years beginning after June 15, 2015. This statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. The System is currently evaluating the effect of Statement 72 will have on its financial statements.
- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68,* issued June 2015. The provisions of this Statement are effective for fiscal years beginning after June 15, 2016. This statement establishes requirements for defined contribution pensions plans not administered through trusts that meet certain criteria. The University has certain employees who were age 40 or older prior to the establishment of each group retirement plan that qualify for minimum annual retirement benefits. The University is currently evaluating the effect Statement No. 73 will have on its statements. As an organizational unit of the University, the System has no additional liability for this potential liability.
- GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, issued June 2015. The provisions of this Statement are effective for fiscal years beginning after June 15, 2017. This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, and expense/expenditures. This statement addresses employers whose employees are provided defined contribution OPEB. The University is working with its actuary to determine the impact of the pronouncement. Although specific amounts are not yet known, this is expected to result in a significant liability for the unfunded portion being recorded on the University's financial statements. 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 unfunded portion.
- GASB Statement No. 76*, The Hierarchy of Generally Accepted Accounting Principles* (GAAP*) for State and Local Governments,* issued June 2015. The provisions of this Statement are effective for fiscal years beginning after June 15, 2015. This statement supersedes Statement No. 55 and raises the category of GASB Implementation Guides in the GAAP hierarchy. The System is currently evaluating the effect of Statement 76 will have on its financial statements.

Reclassifications. Certain reclassifications have been made to the fiscal year 2014 financial statements to conform to the fiscal year 2015 financial statement presentation. These reclassifications had no effect on change in net position.

2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2015 and 2014 follows (in thousands):

	2015	2014
Cash on deposit with the University of Kentucky	$ 431,639	$ 111,668
Investment in University of Kentucky pooled endowment funds	271,708	268,905
	$ 703,347	$ 380,573
Statement of Net Position classification:		
Cash and cash equivalents	$ 272,314	$ 103,253
Restricted cash and cash equivalents	159,325	8,415
Long-term investments	271,708	268,905
	$ 703,347	$ 380,573

The University's pooled endowment fund as of June 30, 2015 and 2014 consisted of the following:

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

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.

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

- Cash on deposit with the University, which the University invests in deposits, money market funds, and repurchase agreements with banks, the Commonwealth and other financial institutions;
- 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.

Deposit and Investment Risks. The System's deposits and investments are exposed to various risks including credit, interest rate and foreign currency risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could affect the investment amounts in the Statements of Net Position.

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing the 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 deposits in excess of FDIC coverage and on repurchase agreements with local banks is mitigated by 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. Money market fund portfolios consist of securities eligible for short-term investments.
- Endowment managers are permitted to use derivative instruments to limit credit risk.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the 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, money market funds and repurchase agreements. These investments are not exposed to custodial credit risk other than repurchase agreements with the Commonwealth, which are held in the Commonwealth's name. Deposits and money market investments are held in the University's name by various financial institutions. 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.
- The University's endowment fixed income managers are limited to a maximum investment in any one issuer of no more than five percent of total investments excluding sovereign debt of governments belonging to the Organization for Economic Cooperation and Development and U.S. agencies.

At June 30, 2015 and 2014, the System had no investments in any one issuer that represented 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. Endowment managers are permitted to use derivative instruments to limit foreign currency risk. .

3. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, as of June 30, 2015 and 2014 are as follows (in thousands):

	2015	2014
Medicare, Medicaid and other third parties	$ 132,452	$ 114,877
Private pay	4,182	5,973
Pledges receivable	1,214	1,336
Total accounts receivable, net	$ 137,848	$ 122,186

At June 30, 2015 and 2014 respectively, pledges are expected to be collected primarily over the next six years, as follows (in thousands):

	2015	2014
Operating purposes	$ 4,743	$ 4,727
Capital projects	2,605	4,188
Total	7,348	8,915
Less discounts and allowances	(3,332)	(3,428)
Total	$ 4,016	$ 5,487
Current in accounts receivable, net	$ 1,214	$ 1,336
Noncurrent in other assets	2,802	4,151
	$ 4,016	$ 5,487

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, 2015 and 2014, the System recorded the discounted value of operating and capital pledges using a rate of two percent.

The System has recorded an allowance for uncollectible patient accounts receivable equal to 25.5% and 24.4% of patient accounts receivable as of June 30, 2015 and 2014, respectively. A summary of the changes in the allowance for uncollectible patient accounts receivable is as follows:

	2015	2014
Balance, beginning of year	$ 27,669	$ 35,493
Provision for bad debts	75,846	133,212
Receivables charged off, net of recoveries	(60,501)	(141,036)
Balance, end of year	$ 43,014	$ 27,669

4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2015 and capital asset activity for the year ended June 30, 2015 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	8,737	-	-	8,737
Buildings	734,330	33,783	338	767,775
Fixed equipment	22,157	1,830	-	23,987
Infrastructure	27,865	1	-	27,866
Equipment	249,453	31,083	20,570	259,966
Vehicles	934	369	84	1,219
Capitalized software	74,080	5,486	-	79,566
Artwork	1,801	49	-	1,850
Construction in process	22,767	34,840	32,069	25,538
Certificate of need	11,609	-	-	11,609
	1,194,678	107,441	53,061	1,249,058
Accumulated Depreciation:				
Depreciable land improvements	4,542	354	-	4,896
Buildings	169,152	17,590	52	186,690
Fixed equipment	11,154	1,849	-	13,003
Infrastructure	4,979	1,115	-	6,094
Equipment	166,099	25,936	16,677	175,358
Vehicles	855	113	84	884
Capitalized software	29,118	6,210	-	35,328
	385,899	53,167	16,813	422,253
Capital assets, net	$ 808,779	$ 54,274	$ 36,248	$ 826,805

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

At June 30, 2015, the System has construction projects in progress totaling approximately $244.9 million in scope. The estimated cost to complete these projects was approximately $218.6 million. Such construction is principally financed by the System's cash reserves, loans from the University and proceeds from the System general receipts bonds.

Interest costs incurred during construction, net of related investment income, are capitalized. Total interest capitalized was $865,000 for 2015 and $454,000 for 2014.

During 2015 and 2014, the System utilized capital leases to acquire various items of equipment. The net book value for capitalized leased land, buildings and equipment is $53.2 million and $68.3 million at June 30, 2015 and 2014, respectively.

5. NOTES RECEIVABLE

Notes receivable at June 30, 2015 and 2014 are as follows (in thousands):

	2015	2014
Non-interest bearing, unsecured receivable from UK College of Pharmacy	$ -	$ 6,723
Non-interest bearing, unsecured receivable from UK College of Pharmacy	5,500	6,000
Non-interest bearing, unsecured receivable from UK College of Pharmacy	-	2,817
Interest bearing, 1.29%, line of credit from Coldstream Laboratories, Inc. through a loan to University of Kentucky Research Foundation	-	2,710
Notes receivable - other	1,592	1,636
Total	$ 7,092	$ 19,886
Current portion	$ 2,667	$ 5,783
Noncurrent portion	4,425	14,103
Total	$ 7,092	$ 19,886

6. OTHER ASSETS

Other assets at June 30, 2015 and 2014 are as follows (in thousands):

	2015	2014
Amounts on deposit with trustee, primarily invested in U.S. government agencies	$ 27	$ 757
Noncurrent portion of prepaid expenses	271	473
Pledges receivable noncurrent	2,802	4,151
Total	$ 3,100	$ 5,381

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2015 and 2014 are summarized as follows (in thousands):

	2015	2014
Payable to vendors and contractors	$ 54,726	$ 57,136
Due to the University of Kentucky	3,680	3,481
Accrued expenses, including vacation leave	64,242	50,631
Total	$ 122,648	$ 111,248

8. LONG-TERM DEBT

Long-term debt as of June 30, 2015 and 2014 are summarized as follows (in thousands):

	2015					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
General Receipts Project Notes	$ 321,010	$ 306,293	$ 192,058	$ 435,245	$ 11,995	$ 423,250
Due to the University of Kentucky and affiliates	29,828	-	4,168	25,660	3,025	22,635
Total	$ 350,838	$ 306,293	$ 196,226	$ 460,905	$ 15,020	$ 445,885

	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

Principal maturities and interest on long-term debt for the next five years and in subsequent five-year periods as of June 30, 2015 are as follows (in thousands):

	Principal	Interest	Total
2016	$ 15,020	$ 20,004	$ 35,024
2017	14,976	19,992	34,968
2018	18,598	19,278	37,876
2019	19,045	18,485	37,530
2020	19,503	17,651	37,154
2021-2025	116,652	73,245	189,897
2026-2030	93,121	46,451	139,572
2031-2035	54,945	31,612	86,557
2036-2040	65,910	18,139	84,049
2041-2045	43,135	5,310	48,445
Total	$ 460,905	$ 270,167	$ 731,072

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 $672.6 million dated October 27, 2005 through April 15, 2015, which bear interest at 2.24% to 4.66%. The bonds are payable in annual installments through June 30, 2045. 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 2009 Bonds Series 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 2015, 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 32% and 33% in 2015 and 2014, respectively.

On July 28, 2014, approximately $66.9 million of University of Kentucky General Receipts 2014 Bonds Series D were issued at a true interest cost of 2.04%. These bonds were issued for the purpose of refunding the General Receipts 2005 Notes issued for the construction of the Patient Care Facility. The bonds will reduce the System's total debt service payments over the next 11 years by approximately $9,019,000 representing an economic gain (difference between the present value of the debt service payments on the old and the new bonds) of approximately $8,023,000.

On April 15, 2015 approximately $141.9 million of University of Kentucky General Receipts 2015 Bonds Series A were issued at a true interest cost of 3.52%. These bonds were issued for the purpose of construction of the Patient Care Facility.

On April 15, 2015 approximately $97.4 million of University of Kentucky General Receipts Bonds 2015 Series B were issued at a true interest cost of 2.33%. These bonds were issued for the purpose of refunding the General Receipts 2007 Notes Series A and B which were originally issued for the construction of the Patient Care Facility. The bonds will reduce the System's total debt service payments over the next 13 years by approximately $3,253,000 representing an economic gain of approximately $2,864,000.

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 1.32% for interest payments in 2015 and 1.24% in 2014. The annual interest rate will be determined March 1 and be effective for the following fiscal year.

At June 30, 2015, assets with a fair market value of approximately $197.5 million have been placed on deposit with trustees to totally defease bonds with a par amount of $180.3 million. The liability for these fully defeased bonds is not included in the financial statements.

9. CAPITAL LEASE OBLIGATIONS

Capital lease obligations as of June 30, 2015 and 2014 are summarized as follows (in thousands):

	2015					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
Leases	$ 72,434	$ 2,296	$ 17,831	$ 56,899	$ 12,170	$ 44,729

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

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

Years ended June 30	
2016	$ 13,864
2017	12,122
2018	8,300
2019	4,913
2020	4,917
2021 and later	22,581
Total	66,697
Less amount representing interest	(9,798)
Present value of net minimum lease payments	$ 56,899

Capital lease obligations are at varying rates of imputed interest of 0.0% to 4.45%.

10. LONG-TERM LIABILITIES – OTHER

Other long-term liabilities as of June 30, 2015 and 2014 are summarized as follows (in thousands):

	2015			
	Beginning Balance	Additions	Reductions	Ending Balance
Refundable deposits	$ 17	$ -	$ 7	$ 10
Unearned compensation	822	259	-	1,081
Workers compensation	-	142	-	142
Noncurrent construction retainage	-	60	-	60
Noncurrent unamortized bond premium	4,448	32,910	642	36,716
Long-term liabilities - other	$ 5,287	$ 33,371	$ 649	$ 38,009

	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

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, 2015 and 2014 are as follows (in thousands):

	2015	2014
Working capital requirements	$ 250,541	$ 140,344
Future capital expenditures	315,063	260,576
Total	$ 565,604	$ 400,920

12. INVESTMENT INCOME (LOSS)

Components of investment income (loss) for the years ended June 30, 2015 and 2014 are as follows (in thousands):

	2015	2014
Interest and dividends earned on endowment investments	$ 2,850	$ 3,355
Realized and unrealized gains and (losses) on endowment investments	2,570	32,982
Interest and dividends on cash and non-endowment investments	(569)	825
Realized and unrealized gains and (losses) on non-endowment investments	(14)	(18)
Total	$ 4,837	$ 37,144

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):

	2015	2014
Revenue from the Commonwealth of Kentucky	$ 9,715	$ 26,487
2.5% tax paid by the System on patient cash receipts	(11,756)	(11,756)
Matching contribution paid by the System	(2,931)	(7,933)
Net amount received (paid) included in net patient service revenues	$ (4,972)	$ 6,798

The amount of charges forgone for services and supplies furnished under the System's charity care policy aggregated to approximately $24.5 million and $108.4 million in 2015 and 2014, 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 2015. Only the General Receipts 2005 Notes Series A, General Receipts 2007 Notes Series A and B, General Receipts 2009 Bonds Series B, General Receipts Bonds 2014 Series D and General Receipts Bonds 2015 Series A and B are reflected as the System debt. Proceeds from the bonds and notes provided funding for the construction of the new patient care facility and the refunding of previously issued notes. The bonds and notes are payable from unrestricted operating and nonoperating revenues and are payable through 2045. Annual principal and interest payments on bonds and notes are expected to require less than three percent of pledged revenues. The total principal and interest remaining to be paid on the bonds and notes is $701.9 million and $493.4 million in 2015 and 2014, respectively. Principal and interest paid for each of the years ended June 30, 2015 and 2014 was $26.3 million and $27.1 million, respectively.

15. RETIREMENT 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 $26.3 million and $23.6 million for the years ended June 30, 2015 and 2014, respectively. Employees contributed $13.1 million and $11.8 million during 2015 and 2014, respectively. The payroll for employees covered by the retirement plans was $262.7 million and $236.3 million for 2015 and 2014, 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% 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% 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 No. 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, 2015.

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 2014 to 2015. Settlements have not exceeded insurance coverage during the past four 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, 2015, 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, 2015. 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 No. 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, 2015.

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, 2015.

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 $10.0 million and $9.2 million respectively in 2015 and 2014 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 2015 and 2014, the System received payments of approximately $26.8 million and $29.2 million, respectively, from the University for the capitation health plan. During 2015 the System received funds from University of Kentucky Research Foundation Inc. from the sale of Coldstream Laboratories, Inc. of approximately $12.4 million included in transfers and approximately $2.7 million in repayment of notes receivable.

Office of the Treasurer
301 Peterson Service Building
Lexington, KY, 40506-0005

www.uky.edu/EVPFA/Controller