

2012 Financial Statements

Research Foundation



**University of Kentucky
Research Foundation
A Component Unit of the University of Kentucky**

CONTENTS	PAGE
Independent Accountants' Report	1
Management's Discussion and Analysis	3
Financial Statements	
Statements of Net Assets	10
Statements of Revenues, Expenses and Changes in Net Assets	11
Statements of Cash Flows	12
Notes to Financial Statements	13
Supplemental Information	
Statement of Net Assets Schedule	25
Statement of Revenues, Expenses and Changes in Net Assets Schedule	26
Board of Directors	

Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors
University of Kentucky
Research Foundation
Lexington, Kentucky

We have audited the accompanying basic financial statements of the University of Kentucky Research Foundation (Foundation), a not-for-profit corporation affiliated with and a component unit of the University of Kentucky, as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the Foundation's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

Board of Directors
University of Kentucky
Research Foundation
Page 2

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

BKD, LLP

September 28, 2012

Management's Discussion and Analysis

The University of Kentucky Research Foundation's (the Foundation) Management's Discussion and Analysis (MD&A) of its financial condition provides an overview of the financial position and activities of the Foundation for the years ended June 30, 2012 and 2011. Management prepares this discussion and encourages readers to utilize its contents in conjunction with the financial statements and the notes appearing in this report.

Financial Highlights

- The financial statements for FY 2011-2012 report a solid financial condition at June 30, 2012. Financial operations were in accordance with the revenue expectations and the approved budget plan.
- Total assets decreased \$2,942,299 or 2.7%. The most significant components of the fluctuation were a \$1,706,378 decrease in other noncurrent assets, net and a \$1,488,924 decrease in other current assets, net.
- Total liabilities decreased \$6,610,342 or 10.2%. Deferred revenue decreased \$5,324,992 and long term liabilities decreased \$2,018,328.
- Total net assets increased \$3,668,043 or 8.4%. Unrestricted net assets increased \$2,503,728, invested in capital assets, net of related debt increased \$1,298,364 and restricted net assets decreased \$134,049.
- Operating revenues increased \$2,779,550 to \$342,274,205.
- Operating expenses increased \$26,698 to \$326,202,418.

Using the Annual Report

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

One of the most important questions asked about the Foundation's finances is whether the Foundation is better off as a result of the year's activities. One key to answering this question is the financial statements of the Foundation. The Statement of Net Assets; Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows present financial information on the Foundation in a format similar to that used by corporations and depict a long-term view of the Foundation's finances. The Foundation's net assets (the difference between assets and liabilities) are one indication of the Foundation's financial health.

Reporting Entity

The University of Kentucky Research Foundation is a not-for-profit Kentucky corporation established to receive, invest and expend funds in promoting and implementing scientific, educational and developmental activities at the University of Kentucky (the University). The Foundation is considered to be an affiliate and component unit of the University because all Board members are related to the University as faculty, staff or trustees and/or are appointed by the Board of Trustees of the University, and certain officers of the Foundation are officers of the University.

The financial statements of the Foundation include the operations of the following entities:

- University of Kentucky Research Foundation
- Kentucky Technology, Inc. (KTI) (a 100% owned, for-profit subsidiary of the Foundation) and its for-profit subsidiaries:
 - Secat, Inc. (100% ownership)
 - Therix Medical, Inc. (69% ownership prior to March 31, 2011, less than 50% ownership and deconsolidated after March 31, 2011)
- Coldstream Laboratories, Inc. (CLI) (a 100% owned, for-profit subsidiary of the Foundation)

KTI and CLI have a calendar-year basis fiscal year from January 1 through December 31. Therefore, the financial statements of KTI and CLI as of December 31, 2011 and December 31, 2010 are included in the Foundation's financial statements as of June 30, 2012 and 2011.

Statement of Net Assets

The Statement of Net Assets includes all assets and liabilities. It is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. A summarized comparison of the Foundation's assets, liabilities and net assets at June 30, 2012, 2011 and 2010 is as follows:

Condensed Statements of Net Assets

	<u>2012</u>	<u>2011</u>	<u>2010</u>
ASSETS			
Current assets	\$ 82,869,788	\$ 84,058,170	\$ 74,972,663
Capital assets	15,091,554	14,478,379	12,065,890
Other noncurrent assets	<u>7,320,443</u>	<u>9,687,535</u>	<u>7,730,822</u>
Total assets	<u>105,281,785</u>	<u>108,224,084</u>	<u>94,769,375</u>
LIABILITIES			
Current liabilities	56,230,138	60,421,335	58,939,359
Noncurrent liabilities	<u>1,778,015</u>	<u>4,197,160</u>	<u>2,488,093</u>
Total liabilities	<u>58,008,153</u>	<u>64,618,495</u>	<u>61,427,452</u>
NET ASSETS			
Invested in capital assets, net of related debt	13,907,139	12,608,775	10,375,487
Restricted			
Nonexpendable	754,509	752,254	751,004
Expendable	3,510,103	3,646,407	3,235,015
Unrestricted	<u>29,101,881</u>	<u>26,598,153</u>	<u>18,980,417</u>
Total net assets	<u>\$ 47,273,632</u>	<u>\$ 43,605,589</u>	<u>\$ 33,341,923</u>

Assets. As of June 30, 2012, the Foundation's assets totaled \$105,281,785. Accounts receivable, primarily from grant sponsors, represented the Foundation's largest asset, totaling \$43,343,908 or 41.2% of total assets. Cash and cash equivalents totaled \$36,712,759 or 34.9% of total assets and capital assets, net totaled \$15,091,554 or 14.3% of total assets.

Total assets decreased \$2,942,299 or 2.7% during the year ended June 30, 2012. The most significant components of the decrease in total assets were a \$1,706,378 decrease in other noncurrent assets, net and a \$1,488,924 decrease in other current assets, net. The other noncurrent asset decrease was due to less invested in CLI after December 31, 2011 than after December 31, 2010. The other current assets, net decrease was mainly due to a decrease in KTI's deferred income taxes.

Liabilities. At June 30, 2012, the Foundation's liabilities totaled \$58,008,153. Deferred revenue amounted to \$33,798,906 or 58.3% of total liabilities. Deferred revenue reflects advance receipts from grant sponsors and other customers. Accounts payable and accrued liabilities totaling \$17,814,939, long-term liabilities of \$2,874,167 and funds due to the University of \$3,520,141 accounted for the remainder of the Foundation's liabilities.

Total liabilities decreased \$6,610,342 during the year ended June 30, 2012. The most significant components of the decrease in total liabilities were a decrease of \$5,324,992 in deferred revenue and \$2,018,328 in long term liabilities. Deferred revenue decreased primarily due to less grant cash received in advance of expenditures. Long term liabilities decreased mainly due to less deferred tax liability recorded by KTI.

Net Assets. Net assets at June 30, 2012 totaled \$47,273,632 or 44.9% of total assets. Net assets invested in capital, net of related debt, totaled \$13,907,139 or 29.4% of total net assets. Restricted net assets totaled \$4,264,612 or 9.0% of total net assets. Unrestricted net assets accounted for \$29,101,881 or 61.6% of total net assets.

Total net assets increased \$3,668,043 during the year ended June 30, 2012. Unrestricted net assets were the most significant component, increasing \$2,503,728, primarily due to revenues from recoveries of facilities and administrative costs exceeding expenses in unrestricted funds. In addition, invested in capital assets, net of related debt increased \$1,298,364 due mainly to capital additions by KTI.

2011 Versus 2010. During the year ended June 30, 2011:

- Total assets increased \$13,454,709 or 14.2%. The most significant components of the increase in total assets was a \$15,484,602 increase in cash and cash equivalents, a \$2,412,489 increase in capital assets, net, partially offset by a \$6,312,635 decrease in accounts receivable. The cash and cash equivalents increase was mainly due to increased collections of grants receivable and increased recoveries of facilities and administrative costs in excess of expenses and transfers. The increase in capital assets, net, was primarily the result of additional capital assets in KTI.
- Total liabilities increased \$3,191,043. The most significant components of the increase in total liabilities were increases of \$2,832,984 in due to the University, \$1,861,173 in deferred revenue and \$1,732,727 in long term liabilities. Due to the University increased because additional funds were loaned to the Foundation by UK HealthCare Hospital System for investment in CLI. Deferred revenue increased primarily due to more grant cash received in advance of expenditures. Long term liabilities increased mainly due to a deferred tax liability recorded by KTI. Offsetting these increases, accounts payable and accrued liabilities decreased \$3,235,841, primarily in the amount owed by grants.
- Total net assets increased \$10,263,666. Unrestricted net assets were the most significant component, increasing \$7,617,736, primarily due to revenues from recoveries of facilities and administrative costs exceeding expenses in unrestricted funds. In addition, invested in capital assets, net of related debt increased \$2,233,288 due mainly to capital additions by KTI.

Statement of Revenues, Expenses and Changes in Net Assets

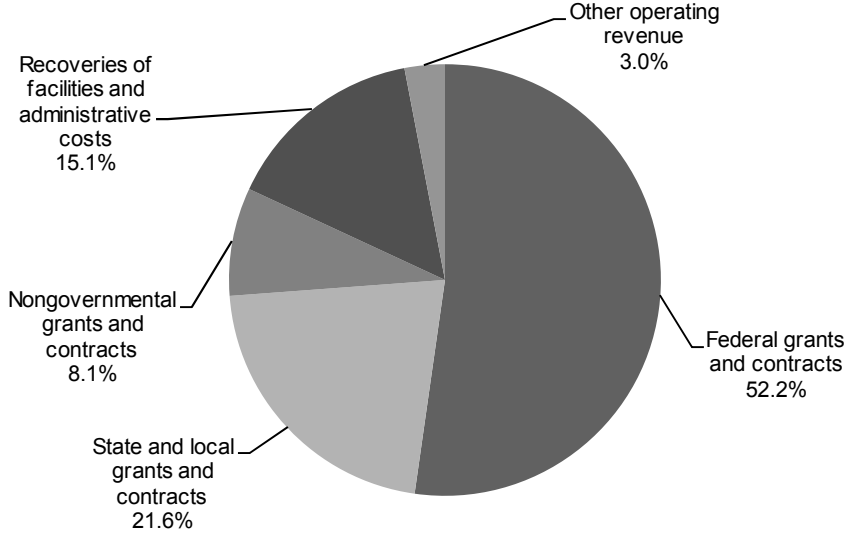
The Statement of Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. GASB 35 requires certain revenue items, such as gifts, investment and endowment income, and patent income, to be classified as nonoperating revenues. The utilization of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. A summarized comparison of the Foundation's revenues, expenses and changes in net assets for the years ended June 30, 2012, 2011 and 2010 is as follows:

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>2012</u>	<u>2011</u>	<u>2010</u>
OPERATING REVENUES			
Federal grants and contracts	\$ 178,613,210	\$ 184,234,729	\$ 172,308,015
State and local grants and contracts	73,843,119	68,954,104	72,218,583
Nongovernmental grants and contracts	28,045,352	26,717,448	25,243,830
Recoveries of facilities and administrative costs	51,542,511	52,808,778	50,599,314
Other operating revenue	10,230,013	6,779,596	7,222,773
Total operating revenues	<u>342,274,205</u>	<u>339,494,655</u>	<u>327,592,515</u>
OPERATING EXPENSES			
Research	173,392,870	185,031,677	178,673,810
Other educational and general	149,663,276	138,772,392	132,671,354
Student financial aid	1,718,883	1,245,285	1,136,276
Depreciation	1,427,389	1,126,366	888,580
Total operating expenses	<u>326,202,418</u>	<u>326,175,720</u>	<u>313,370,020</u>
OPERATING INCOME	<u>16,071,787</u>	<u>13,318,935</u>	<u>14,222,495</u>
NONOPERATING REVENUES (EXPENSES)			
Gifts	130,600	80,500	80,500
Investment income (loss)	203,236	671,173	698,800
Patent income	1,263,082	1,657,467	1,715,329
Interest on capital asset-related debt	(76,822)	(158,089)	(226,693)
Other nonoperating revenues and expenses, net	21,842	313,708	130,482
Capital grants and gifts	23,471,226	15,849,799	6,810,520
Additions to permanent endowments	2,255	1,250	50
Grants to the University of Kentucky	(36,937,599)	(21,471,077)	(10,993,277)
Other	(481,564)	-	(22,605)
Total nonoperating revenues (expenses)	<u>(12,403,744)</u>	<u>(3,055,269)</u>	<u>(1,806,894)</u>
Total increase in net assets	3,668,043	10,263,666	12,415,601
Net assets, beginning of year	<u>43,605,589</u>	<u>33,341,923</u>	<u>20,926,322</u>
Net assets, end of year	<u>\$ 47,273,632</u>	<u>\$ 43,605,589</u>	<u>\$ 33,341,923</u>

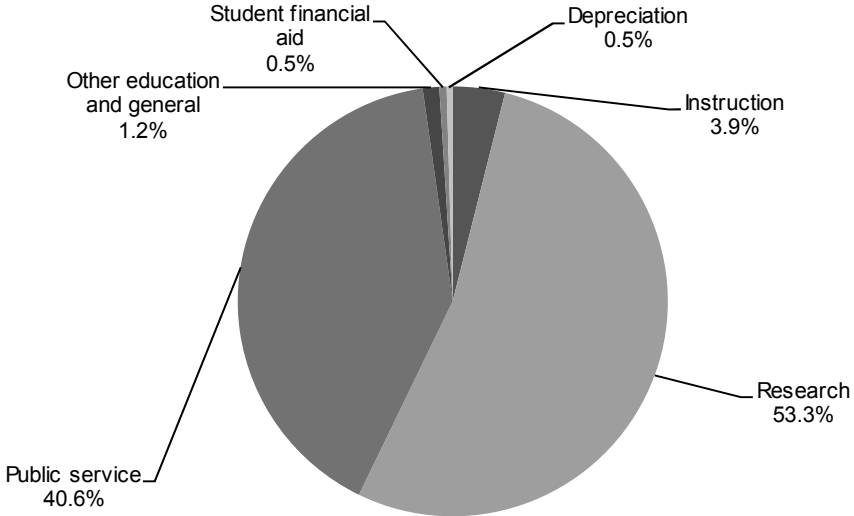
Total operating revenues, consisting primarily of grants and contracts, and related recoveries of facilities and administrative costs, were \$342,274,205 for the year ended June 30, 2012. Federal, state and nongovernmental grants and contracts, and related recoveries of facilities and administrative costs, accounted for nearly 100% of operating revenues. Operating revenues increased \$2,779,550 or 0.8%, primarily caused by a \$4,889,015 or 7.1% increase in state and local grants and contracts and an increase of \$3,450,417 or 50.9% in other operating revenues. The increase in state and local grants and contracts was mainly caused by increases in several grants, mainly the Department of Corrections Health Care Network grant. The increase in other operating revenues was caused by an increase in sales at CLI. Offsetting these increases was a decrease of \$5,621,519 or 3.1% in federal grants and contracts resulting from decreases in grants funded by the American Recovery and Reinvestment Act of 2009.

TOTAL OPERATING REVENUES



Operating expenses totaled \$326,202,418. Of this amount, \$173,392,870 or 53.3% was used for research expenses, \$132,776,221 or 40.6% was used for public service expenses and \$12,728,620 or 3.9% was used for instruction. Operating expenses increased marginally, \$26,698. This increase was primarily attributable to an increase in public service activity, offset by expenses associated with decreased research and instruction activity.

TOTAL OPERATING EXPENSES



2011 Versus 2010. Total operating revenues, consisting primarily of grants and contracts, and related recoveries of facilities and administrative costs, were \$339,494,655. Federal, state and nongovernmental grants and contracts, and related recoveries of facilities and administrative costs, accounted for nearly 100% of operating revenues. Operating revenues increased \$11,902,140 or 3.6%, primarily caused by a \$11,926,714 or 6.9% increase in federal grants and contracts and an increase of \$2,209,464 or 4.4% in recoveries of facilities and administrative costs. These increases were mainly caused by increased federal grants and contracts resulting from the American Recovery and Reinvestment Act of 2009.

Operating expenses totaled \$326,175,720. Of this amount, \$185,031,677 or 56.7% was used for research expenses, \$119,247,161 or 36.6% was used for public service expenses and \$15,242,828 or 4.7% was used for instruction. Operating expenses increased \$12,805,700 or 4.1%. This increase was primarily attributable to expenses associated with increased research, instruction and public service activity.

Statement of Cash Flows

The Statement of Cash Flows presents information related to the Foundation's cash inflows and outflows and is summarized by operating, capital financing, noncapital financing and 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 Foundation during the year that will allow financial statement readers to assess the entity's:

- ability to generate future net cash flows,
- ability to meet obligations as they become due, and
- the possible need for external financing.

A comparative summary of the Foundation's statement of cash flows for the years ended June 30, 2012, 2011 and 2010 is as follows:

Condensed Statements of Cash Flows

	2012	2011	2010
CASH PROVIDED (USED) BY:			
Operating activities	\$13,363,640	\$19,727,417	\$11,745,086
Noncapital financing activities	(6,848,464)	(231,762)	(3,740,544)
Capital and related financing activities	(7,978,417)	(3,883,624)	(4,296,889)
Investing activities	512,336	(127,429)	503,794
Net increase (decrease) in cash and cash equivalents	(950,905)	15,484,602	4,211,447
Cash and cash equivalents, beginning of year	37,663,664	22,179,062	17,967,615
Cash and cash equivalents, end of year	\$36,712,759	\$37,663,664	\$22,179,062

Major sources of cash included in operating activities were grants and contracts of \$277,043,787 and recoveries of facilities and administrative costs of \$50,780,218. The largest cash payments for operating activities were made to suppliers of \$153,049,164 and to the University as reimbursements for employee salaries and benefits of \$163,365,723.

The largest use of cash in the noncapital financing activities group related to grants to the University totaling \$8,838,400. Cash provided in this category is mostly from other receipts of \$1,857,081, primarily patent income.

Cash used by capital and related financing activities was primarily expended on grants to the University for the construction and acquisition of capital assets totaling \$27,670,954 and purchases of capital assets of \$3,227,279, offset by capital grants and gifts of \$23,471,226.

Cash provided by investing activities reflects proceeds from sales and maturities of investments of \$2,096,547 and interest and dividends on investments of \$577,014, net of cash used to purchase investments of \$2,161,225.

2011 Versus 2010. Cash increased \$15,484,602 primarily due to cash flows provided by operating activities offset by cash used by investing activities, capital and related financing activities and noncapital financing activities.

Capital Asset and Debt Administration

Capital Assets. Capital assets, net of accumulated depreciation, totaled \$15,091,554 at June 30, 2012, an increase of \$613,175. Capital assets as of June 30, 2012, and significant changes in capital assets during the years ended June 30, 2012 and 2011 are as follows (in thousands):

	Balance June 30, 2010	Net Additions FY 10-11	Balance June 30, 2011	Net Additions FY 11-12	Balance June 30, 2012
Land	\$ 2,336		\$ 2,336		\$ 2,336
Buildings	2,265	\$ 1,113	3,378	\$ (354)	3,024
Infrastructure	-	5,021	5,021	1,040	6,061
Equipment	7,410	679	8,089	657	8,746
Vehicles	21	-	21	-	21
Software	-	89	89	41	130
Construction in progress	4,069	(3,364)	705	574	1,279
Accumulated depreciation	(4,035)	(1,126)	(5,161)	(1,344)	(6,505)
Total	<u>\$ 12,066</u>	<u>\$ 2,412</u>	<u>\$ 14,478</u>	<u>\$ 614</u>	<u>\$ 15,092</u>

Debt. The Foundation had long-term liabilities totaling \$2,874,167 at June 30, 2012 for capital leases of \$686,751 by CLI, \$1,242,316 other long-term liabilities of CLI and \$945,100 other long-term liabilities of KTI. The Foundation had long-term liabilities totaling \$4,892,495 at June 30, 2011 for capital leases of \$916,474 by CLI, \$1,191,669 other long-term liabilities of CLI and \$2,784,352 other long-term liabilities of KTI.

Factors Impacting Future Periods

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

- At June 30, 2012, grants and contracts of \$191,499,215 had been awarded to the Foundation, but not expended. These grants and contracts are available to provide revenue to future periods and will be recognized as expended.
- The Foundation is funded primarily by grants and contracts funded by sponsors. Operating revenues in grants and contracts showed a slight decline this year due to a decrease in funds available from grants and contracts awarded as part of the American Recovery and Reinvestment Act of 2009. Not only has this source of funding ended, further declines in federal awards are anticipated and could have a serious impact in future fiscal years. In addition, if the current economic environment continues, it could make it more difficult for sponsors in the future to continue funding grants and contracts near the current levels. This would have a negative impact on the Foundation's future financial results.

UNIVERSITY OF KENTUCKY RESEARCH FOUNDATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF NET ASSETS
JUNE 30, 2012 AND 2011

	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 36,712,759	\$ 37,663,664
Accounts receivable	43,343,908	42,443,711
Investments	351,250	-
Other current assets, net	2,461,871	3,950,795
Total current assets	<u>82,869,788</u>	<u>84,058,170</u>
Noncurrent Assets		
Endowment investments	3,598,169	3,928,366
Other long term investments	1,472,274	1,802,791
Other noncurrent assets, net	2,250,000	3,956,378
Capital assets, net	15,091,554	14,478,379
Total noncurrent assets	<u>22,411,997</u>	<u>24,165,914</u>
Total assets	<u>105,281,785</u>	<u>108,224,084</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	17,814,939	16,813,742
Deferred revenue	33,798,906	39,123,898
Due to the University of Kentucky	3,520,141	3,788,360
Long-term liabilities - current portion	1,096,152	695,335
Total current liabilities	<u>56,230,138</u>	<u>60,421,335</u>
Noncurrent Liabilities		
Long-term liabilities	1,778,015	4,197,160
Total noncurrent liabilities	<u>1,778,015</u>	<u>4,197,160</u>
Total liabilities	<u>58,008,153</u>	<u>64,618,495</u>
NET ASSETS		
Invested in capital assets, net of related debt	<u>13,907,139</u>	<u>12,608,775</u>
Restricted		
Nonexpendable	754,509	752,254
Expendable	3,510,103	3,646,407
Total restricted	<u>4,264,612</u>	<u>4,398,661</u>
Unrestricted		
Total net assets	<u>\$ 47,273,632</u>	<u>\$ 43,605,589</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY RESEARCH FOUNDATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

	2012	2011
OPERATING REVENUES		
Federal grants and contracts	\$ 178,613,210	\$ 184,234,729
State and local grants and contracts	73,843,119	68,954,104
Nongovernmental grants and contracts	28,045,352	26,717,448
Recoveries of facilities and administrative costs	51,542,511	52,808,778
Other operating revenues	10,230,013	6,779,596
Total operating revenues	<u>342,274,205</u>	<u>339,494,655</u>
OPERATING EXPENSES		
Educational and general:		
Instruction	12,728,620	15,242,828
Research	173,392,870	185,031,677
Public service	132,776,221	119,247,161
Academic support	2,678,591	3,298,154
Student services	30,663	28,024
Institutional support	995,961	873,689
Operations and maintenance of plant	453,220	82,536
Student financial aid	1,718,883	1,245,285
Depreciation	1,427,389	1,126,366
Total operating expenses	<u>326,202,418</u>	<u>326,175,720</u>
Net income (loss) from operations	<u>16,071,787</u>	<u>13,318,935</u>
NONOPERATING REVENUES (EXPENSES)		
Gifts	130,600	80,500
Investment income (loss)	203,236	671,173
Patent income	1,263,082	1,657,467
Grants (to) from the University of Kentucky for noncapital purposes	(8,570,181)	(6,371,317)
Interest on capital asset-related debt	(76,822)	(158,089)
Other nonoperating revenues and expenses	21,842	313,708
Net nonoperating revenues (expenses)	<u>(7,028,243)</u>	<u>(3,806,558)</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>9,043,544</u>	<u>9,512,377</u>
Capital grants and gifts	23,471,226	15,849,799
Additions to permanent endowments	2,255	1,250
Grants (to) from the University of Kentucky for capital purposes	(28,367,418)	(15,099,760)
Other, net	(481,564)	-
Total other revenues (expenses)	<u>(5,375,501)</u>	<u>751,289</u>
Increase (decrease) in net assets	3,668,043	10,263,666
NET ASSETS, beginning of year	<u>43,605,589</u>	<u>33,341,923</u>
NET ASSETS, end of year	<u>\$ 47,273,632</u>	<u>\$ 43,605,589</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY RESEARCH FOUNDATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011**

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Grants and contracts	\$ 277,043,787	\$ 287,843,240
Recoveries of facilities and administrative costs	50,780,218	54,528,557
Payments to vendors and contractors	(153,049,164)	(162,602,958)
Salaries, wages and benefits reimbursement to the University of Kentucky	(163,365,723)	(158,610,801)
Salaries, wages and benefits	(6,751,772)	(5,649,096)
Other receipts (payments)	8,706,294	4,218,475
Net cash provided (used) by operating activities	<u>13,363,640</u>	<u>19,727,417</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Gifts and grants received for other than capital purposes:		
Private gifts for endowment purposes	2,255	1,250
Private gifts for other purposes	130,600	80,500
Grants (to) from the University of Kentucky	(8,838,400)	(3,538,333)
Other receipts (payments)	1,857,081	3,224,821
Net cash provided (used) by noncapital financing activities	<u>(6,848,464)</u>	<u>(231,762)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	(27,670,954)	(15,599,794)
Capital grants and gifts	23,471,226	15,849,799
Purchases of capital assets	(3,227,279)	(3,821,427)
Proceeds from capital debt	590,622	600,000
Principal paid on capital debt and leases	(1,307,495)	(799,702)
Interest paid on capital debt and leases	(76,822)	(158,089)
Other receipts (payments)	242,285	45,589
Net cash provided (used) by capital and related financing activities	<u>(7,978,417)</u>	<u>(3,883,624)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	2,096,547	3,794,723
Interest and dividends on investments	577,014	34,711
Purchase of investments	(2,161,225)	(3,956,863)
Net cash provided (used) by investing activities	<u>512,336</u>	<u>(127,429)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(950,905)</u>	<u>15,484,602</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>37,663,664</u>	<u>22,179,062</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 36,712,759</u>	<u>\$ 37,663,664</u>
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	\$ 16,071,787	\$ 13,318,935
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Depreciation expense	1,427,389	1,126,366
Change in assets and liabilities:		
Accounts receivable	(900,427)	6,312,865
Other current assets	2,958,772	(2,558,488)
Accounts payable and accrued liabilities	768,193	(2,707,363)
Long-term liabilities	(1,301,455)	1,932,429
Deferred revenue	(5,660,619)	2,302,673
Net cash provided (used) by operating activities	<u>\$ 13,363,640</u>	<u>\$ 19,727,417</u>
NONCASH TRANSACTIONS		
Equipment acquired through capital lease	\$ 240,623	\$ -
Capital asset transfer from the University of Kentucky	\$ 598,279	\$ 526,374
Capital asset additions in accounts payable	\$ 301,560	\$ 166,147
CPST building lease payments - CLI	\$ (119,952)	\$ (119,952)

See notes to financial statements

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The University of Kentucky Research Foundation (the Foundation) is a not-for-profit Kentucky corporation established to receive, invest and expend funds in promoting and implementing scientific, educational and developmental activities at the University of Kentucky (the University). The Foundation is considered to be an affiliate and component unit of the University because all Board members are related to the University as faculty, staff or trustees and/or are appointed by the Board of Trustees of the University, and certain officers of the Foundation are officers of the University.

The financial statements of the Foundation include the operations of the following entities:

- University of Kentucky Research Foundation
- Kentucky Technology, Inc. (KTI) (a 100% owned, for-profit subsidiary of the Foundation) and its for-profit subsidiaries:
 - Secat, Inc. (100% ownership)
 - Therix Medical, Inc. (69% ownership prior to March 31, 2011, less than 50% ownership and deconsolidated after March 31, 2011)
- Coldstream Laboratories, Inc. (CLI) (a 100% owned, for-profit subsidiary of the Foundation)

KTI and CLI have a calendar-year basis fiscal year from January 1 through December 31. Therefore, the financial statements of KTI and CLI as of December 31, 2011 and December 31, 2010 are included in the Foundation's financial statements as of June 30, 2012 and 2011.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net assets categories:

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

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the Foundation's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows.

During the year ended June 30, 2012, the Foundation adopted *Statement of Governmental Accounting Standards Board (GASB) No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes *GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that statement for business-type activities to apply post-November 30, 1989, FASB statements and interpretations that do not conflict with or contradict GASB pronouncements. GASB No. 62 has been applied retrospectively and had no impact on the Foundation's net assets, changes in net assets or financial reporting disclosures.

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 Foundation reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35. BTAs 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 Foundation considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Pooled Endowment Funds. The Foundation's endowment investments are administered as part of the University's pooled endowment funds. All contributing endowments participate in the income and appreciation of the pool on a per unit basis commensurate with their contribution to the pool. New endowments purchase units in the pool at the current unit value which is calculated each month based on the fair value of the pool investments divided by the number of pool units outstanding. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

In accordance with the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), as adopted by the Commonwealth of Kentucky 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 utilizes a spending policy designed to smooth spending distributions and protect endowed programs from market volatility by calculating distributions based on a percentage of the average market value of the endowment over a specified period of time. The University has made expenditure decisions in accordance with prevailing UPMIFA statute and donor gift agreements. UPMIFA allows institutions to appropriate for expenditure so much of an endowment fund as the institution deems is prudent based on a review of various factors set forth in the Act, subject to terms set forth in a gift agreement.

For the year ended June 30, 2012 the University's endowment spending rule provided for annual distributions of 4.25 percent of the sixty month moving average market value of fund units. For the year ended June 30, 2011, the University's endowment spending rule provided for annual distributions of 4.375 percent of the sixty month moving average market value of fund units. The amount available for spending in accordance with the University's endowment spending policy was \$91,530 and \$96,775 for the years ended June 30, 2012 and 2011, respectively. Additionally, for the year ended June 30, 2012, the University assessed eligible endowment accounts with a management fee of 0.25 percent of total asset value. For the year ended June 30, 2011, the University assessed eligible endowment accounts with a management fee of 0.375 percent of total asset value.

The Investment Committee of the University's Board of Trustees has approved a spending rate distribution of 4.25 percent of a sixty month moving average market value of fund units for the year ended June 30, 2013. Additionally, the Investment Committee has approved a management fee of 0.25 percent for the year ended June 30, 2013.

Investments. Investments in marketable securities are carried at fair value, as determined by the major securities markets. Certain KTI investments in companies are accounted for on the cost or equity method, depending on control and KTI's ability to exercise significant influence, and are included in other noncurrent assets. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income in the Statement of Revenues, Expenses and Changes in Net Assets.

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.

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. 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, and 5 – 20 years for equipment and vehicles.

Accounts Receivable. This classification consists of amounts due from sponsors and other customers for reimbursement of expenses made pursuant to contracts and grants. Accounts receivable are recorded net of estimated uncollectible amounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. Allowances for uncollectible amounts are not significant in the current or previous fiscal years.

Deferred Revenue. Deferred revenue consists primarily of amounts received from grant and contract sponsors which have not yet been earned under the terms of the agreement.

Income Taxes. The Foundation is exempt from federal income tax under the Internal Revenue Code, as a 501(c)(3) organization. KTI and its subsidiaries, and CLI, are subject to federal and state income taxes and have accrued such income taxes payable. Income taxes are not significant to the financial statements.

Restricted Asset Spending Policy. The Foundation'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 Foundation defines operating activities, as reported on the Statement of Revenues, Expenses and Changes in Net Assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for goods and services received. Nearly all of the Foundation's expenses are from exchange transactions. Certain revenues relied upon for operations, such as gifts and investment and patent income, are recorded as nonoperating 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 use estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The accompanying financial statements include estimates for items such as bad debt, accrued expenses and other liability accounts.

2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2012 and 2011 is as follows:

	2012	2011
Cash on deposit with local banks and the University of Kentucky	\$ 36,712,759	\$ 37,663,664
Investment in University of Kentucky pooled endowment fund	3,598,169	3,928,366
Government agency fixed income securities	30,177	-
Investment in pooled equity funds	101,307	140,657
Investment in private equity funds	1,330,295	1,488,399
Common stocks	10,389	14,363
Certificates of deposit	351,250	159,266
Other	106	106
	\$ 42,134,452	\$ 43,394,821
	2012	2011
Statement of Net Assets classification		
Cash and cash equivalents	\$ 36,712,759	\$ 37,663,664
Investments	351,250	-
Endowment investments	3,598,169	3,928,366
Other long-term investments	1,472,274	1,802,791
	\$ 42,134,452	\$ 43,394,821

At June 30, 2012, the University's pooled endowment fund consisted of common and preferred stock (3.6%), pooled equity funds (37.5%), pooled private equity funds (7.5%), pooled absolute return funds (19.7%), pooled real return funds (9.5%), pooled real estate funds (6.6%), U.S. treasury fixed income (1.0%), government agency fixed income funds (1.0%), corporate fixed income funds (2.9%), pooled fixed income funds (10.5%) and cash and cash equivalents (0.2%). At June 30, 2011, the University's pooled endowment fund consisted of common and preferred stock (4.3%), pooled equity funds (38.0%), pooled private equity funds (4.7%), pooled absolute return funds (19.1%), pooled real return funds (10.4%), pooled real estate funds (5.5%), U.S. treasury fixed income (0.8%), government agency fixed income funds (1.8%), corporate fixed income funds (2.2%), pooled fixed income funds (13.1%) and cash and cash equivalents (0.1%).

Deposit and investment policies. The Foundation follows the deposit and investment policies established by the University of Kentucky's Board of Trustees. Such policies are developed to establish and maintain sound financial management practices for the investment and management of the Foundation's funds.

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

- Cash on deposit with the University of Kentucky, which the University invests in deposits and repurchase agreements and the Commonwealth of Kentucky,
- Cash on deposit with local banks, and
- Endowment investments in the University's pooled endowment fund.

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

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 Foundation's deposits and investments are exposed to various risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could affect the investment amounts in the statement of net assets.

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing the Foundation to experience a loss of principal.

As a means of limiting its exposure to losses arising from credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Cash on deposit with the University of Kentucky is governed by policy that minimizes risk in several ways. Deposits are governed by state law which requires full collateralization for balances exceeding amounts covered by the Federal Deposit Insurance Corporation. On November 9, 2010, the FDIC Board of Directors issued a final rule to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that provides temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts at all FDIC-insured depository institutions (the "Dodd-Frank Provision"). The separate coverage for noninterest-bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012. The Foundation's deposits are non-interest bearing and are fully insured by FDIC coverage. Credit risk on deposits in local banks is minimized by the financial institutions' participation in the Federal Deposit Insurance Corporation's (FDIC) insurance coverage.
- Credit risk on repurchase agreements is mitigated by requiring the issuing financial institution's pledge of specific U.S. treasury or agency securities, held in the name of the University by the Federal Reserve Bank. Credit risk on repurchase agreements with the Commonwealth of Kentucky is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth. Endowment managers are permitted to use derivative instruments to limit credit risk. Additionally, endowment investments held by the University's fixed income managers are generally limited to holdings of high quality fixed income securities. These managers may invest a portion of the portfolio in other below-investment grade bonds, non-U.S. dollar denominated bonds, and emerging market bonds, provided the overall credit quality of the fixed income portfolios is not lower than A-.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Foundation will not be able to recover the value of its investment or collateral securities that are in possession of an outside party.

As a means of limiting its exposure to losses arising from custodial credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Cash on deposit with the University is invested in deposits and repurchase agreements and held in the University's name. Deposits and repurchase agreements with the Commonwealth of Kentucky are held in the Commonwealth's name. The University maintains records evidencing the Foundation's ownership interest in such balances.
- Custodial credit risk on deposits in local banks is minimized by the financial institutions' participation in the FDIC's insurance coverage.
- Endowment investments are held in the University's name by the University's custodian. The University maintains records of the Foundation's ownership interest (units) in the University's pooled endowment fund.

Concentrations of Credit Risk. Foundation investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer.

As a means of limiting its exposure to concentrations of credit risk, the University's investment policies limit concentrations in various investment types, as follows:

- Cash on deposit with the University is not limited as to the maximum amount that may be invested in one issuer. However, all such deposits in excess of Federal Depository Insurance are required to be fully collateralized by U.S. treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- Cash on deposit with local banks is not limited to a maximum amount that may be invested in one issuer. However, all deposits are covered by the FDIC's insurance coverage.
- The University's endowment investment managers are limited to a maximum investment in any one issuer of no more than 5% of total investments excluding sovereign debt of governments belonging to the Organization for Economic Cooperation and Development and U.S. agencies.

At June 30, 2012, the Foundation had a certificate of deposit at a local bank that represented 7% of investments. Concentration risk is minimized by the financial institution's participation in the FDIC's insurance coverage.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Cash on deposit with the University has limited exposure to interest rate risk due to the short-term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Cash on deposit with local banks has limited exposure to interest rate risk due to the short-term nature of the investment.
- Endowment managers are permitted to use derivative instruments to limit interest rate risk. Additionally, endowment investments held by the University's fixed income managers are limited to a duration that is within +/-25% of the duration of the Barclays Aggregate Bond Index.

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit.

The Foundation's exposure to foreign currency risk derives from certain endowment investments of the University's pooled endowment fund. The University's investment policy allows fixed-income managers to invest a portion of their portfolios in non-U.S. securities. Additionally, the investment policy allows various pooled fund managers to invest in accordance with the guidelines established in each individual fund's prospectus, which allows for investment in non-U.S. securities. The University's investments in the various pooled funds are denominated in U.S. dollars, with the exception of two private equity funds denominated in Euros. Endowment managers are permitted to use derivative instruments to limit foreign currency risk.

3. TRANSACTIONS WITH RELATED PARTIES

Salaries, wages and benefits reimbursements represent charges for University employees. Grants to the University primarily consist of funds transferred in compliance with an agreement between the Foundation and the University, whereby the University provides general support of facilities, personnel and programs in exchange for an annual grant. For fiscal year 2012, UKRF subsidiary CLI received a line of credit from UKRF through amounts advanced by UK Healthcare Hospital System for \$3,000,000, with interest adjusted annually on March 1 to the two-year U.S. treasury rate plus one percent (1.29 percent at December 31, 2011). Interest began to accumulate upon initial transfer of funds. Payment term on the line of credit is five years from the date of the final cash transfer. The agreement has no set maturity date.

As of December 31, 2011, no amount was outstanding under this line of credit as reflected within the financial statements. As of June 30, 2012, \$1,118,835 had been drawn on the line of credit. In addition to the line of credit arrangement, on December 13, 2011, the University approved the transfer of up to \$4,000,000 to CLI to fund operations and capital improvements. As of December 31, 2011, \$0 of this funding had been transferred to CLI as reflected within the financial statements. As of June 30, 2012, \$2,250,000 had been transferred to fund operations and capital improvements. For fiscal year 2011, UKRF subsidiary CLI recorded other nonoperating revenues of \$446,401 from UK HealthCare Hospital System related to certain expenses incurred by CLI.

4. ACCOUNTS RECEIVABLE

Accounts receivable as of June 30, 2012 and 2011, totaling \$43,343,908 and \$42,443,711, respectively, primarily represent net reimbursements receivable from sponsors for funds expended on grants and contracts.

5. OTHER CURRENT ASSETS

Other current assets as of June 30, 2012 and 2011 are summarized as follows:

	<u>2012</u>	<u>2011</u>
Deferred charges - patents	\$ 1,601,854	\$ 1,844,513
Inventories	555,396	411,109
Deferred income taxes	157,636	1,439,788
Other	146,985	255,385
Total	<u>\$ 2,461,871</u>	<u>\$ 3,950,795</u>

6. CAPITAL ASSETS, NET

Capital assets as of June 30, 2012 are summarized as follows:

	<u>2012</u>			
	Beginning Balance	Additions	Deletions	Ending Balance
<u>Capital Assets</u>				
Land	\$ 2,336,455			\$ 2,336,455
Buildings	3,378,018	\$ 251,971	\$ 605,852	3,024,137
Infrastructure	5,021,392	1,039,676	-	6,061,068
Equipment	8,088,787	680,246	23,240	8,745,793
Vehicles	21,034	-	-	21,034
Software	88,627	41,371	-	129,998
Construction in process	705,802	751,149	177,460	1,279,491
	<u>19,640,115</u>	<u>2,764,413</u>	<u>806,552</u>	<u>21,597,976</u>
<u>Accumulated Depreciation</u>				
Buildings	1,091,104	155,441	7,573	1,238,972
Infrastructure	100,428	210,234	-	310,662
Equipment	3,877,681	1,045,765	75,130	4,848,316
Vehicles	14,198	4,207	-	18,405
Software	78,325	11,742	-	90,067
	<u>5,161,736</u>	<u>1,427,389</u>	<u>82,703</u>	<u>6,506,422</u>
Net capital assets	<u>\$ 14,478,379</u>	<u>\$ 1,337,024</u>	<u>\$ 723,849</u>	<u>\$ 15,091,554</u>

The net book value of capitalized leased equipment was \$1,333,781 at December 31, 2011 for CLI.
Capital assets as of June 30, 2011 are summarized as follows:

	2011			
<u>Capital Assets</u>	Beginning Balance	Additions	Deletions	Ending Balance
Land	\$ 2,336,455			\$ 2,336,455
Buildings	2,265,226	\$ 1,112,792		3,378,018
Infrastructure	-	5,021,392		5,021,392
Equipment	7,409,778	724,598	\$ 45,589	8,088,787
Vehicles	21,034	-	-	21,034
Software	-	88,627	-	88,627
Construction in process	4,068,767	2,849,206	6,212,171	705,802
	<u>16,101,260</u>	<u>9,796,615</u>	<u>6,257,760</u>	<u>19,640,115</u>
 <u>Accumulated Depreciation</u>				
Buildings	939,013	152,091	-	1,091,104
Infrastructure	-	100,428	-	100,428
Equipment	3,086,366	791,315	-	3,877,681
Vehicles	9,991	4,207	-	14,198
Software	-	78,325	-	78,325
	<u>4,035,370</u>	<u>1,126,366</u>	<u>-</u>	<u>5,161,736</u>
 Net capital assets	 <u>\$ 12,065,890</u>	 <u>\$ 8,670,249</u>	 <u>\$ 6,257,760</u>	 <u>\$ 14,478,379</u>

The net book value of capitalized leased equipment was \$1,337,781 at December 31, 2010 for CLI.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2012 and 2011 are as follows:

	2012	2011
Payable to vendors and contractors	\$ 15,676,572	\$ 13,814,238
Due to the University of Kentucky	1,476,802	927,824
Due to the University of Kentucky for accrued payroll	4,334	1,792,130
Accrued payroll	641,994	263,719
Accrued interest	15,237	15,831
Total	<u>\$ 17,814,939</u>	<u>\$ 16,813,742</u>

8. DEFERRED REVENUE

Deferred revenue as of June 30, 2012 and 2011 is as follows:

	2012	2011
Unearned grants and contracts revenue	\$ 31,040,898	\$ 37,268,550
Unearned patent intellectual property	1,114,413	778,786
Other	1,643,595	1,076,562
Total	<u>\$ 33,798,906</u>	<u>\$ 39,123,898</u>

9. LONG TERM LIABILITIES

Long-term liabilities as of June 30, 2012 and 2011 are summarized as follows:

	2012					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
Capital leases	\$ 916,474	\$ 240,622	\$ 470,345	\$ 686,751	\$ 473,643	\$ 213,108
Deferred tax liability	2,052,381	290,417	1,471,921	870,877	-	870,877
Other long-term liabilities	1,923,640	350,000	957,101	1,316,539	622,509	694,030
Total long-term liabilities	<u>\$ 4,892,495</u>	<u>\$ 881,039</u>	<u>\$ 2,899,368</u>	<u>\$ 2,874,167</u>	<u>\$ 1,096,152</u>	<u>\$ 1,778,015</u>

Included in the other long-term liabilities ending balance as of June 30, 2012 is an amount owed to the University of Kentucky from CLI of \$639,746.

	2011					
	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
Capital leases	\$ 1,266,284		\$ 349,810	\$ 916,474	\$ 378,742	\$ 537,732
Deferred tax liability		\$ 2,052,381	-	2,052,381	-	2,052,381
Other long-term liabilities	1,893,484	600,000	569,844	1,923,640	316,593	1,607,047
Total long-term liabilities	<u>\$ 3,159,768</u>	<u>\$ 2,652,381</u>	<u>\$ 919,654</u>	<u>\$ 4,892,495</u>	<u>\$ 695,335</u>	<u>\$ 4,197,160</u>

Included in the other long-term liabilities ending balance as of June 30, 2011 is an amount owed to the University of Kentucky from CLI of \$759,699.

Principal maturities and interest on long-term liabilities, excluding deferred tax liability, for the next five years and in subsequent five-year periods as of June 30, 2012 are as follows:

	Principal	Interest	Total
2013	\$ 1,096,153	\$ 39,245	\$ 1,135,398
2014	797,791	10,446	808,237
2015	38,657	6,028	44,685
2016	41,283	3,402	44,685
2017	29,406	725	30,131
	<u>\$ 2,003,290</u>	<u>\$ 59,846</u>	<u>\$ 2,063,136</u>

10. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Interest and dividends earned on endowment investments	\$ 59,157	\$ 63,732
Realized and unrealized gains and losses on endowment investments	(86,854)	545,264
Interest on cash and non-endowment investments	216,022	46,503
Investment income from external trusts	14,911	15,674
Total	<u>\$ 203,236</u>	<u>\$ 671,173</u>

11. GRANTS AND CONTRACTS AWARDED

At June 30, 2012, grants and contracts of \$191,499,215 had been awarded to the Foundation, but not expended. These contracts are available to provide grant revenue to future periods and will be recognized as expended.

12. RISK MANAGEMENT

The Foundation is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omission; and natural disasters. These risks are covered by the State Fire and Tornado Insurance Fund (the Fund), commercial insurance, extension of coverage by the University's participation in an insurance risk retention group and self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and other named perils between \$250,000 and \$500,000 per occurrence. Losses in excess of \$500,000 are insured by commercial carriers up to \$1.00 billion per occurrence on an actual cash value basis. Claims against directors, officers and employees for wrongful acts (errors and omission) are insured through a risk retention group. There have been no significant reductions in insurance coverage from 2011 to 2012. Settlements have not exceeded insurance coverage during the past three years.

13. LEASING ARRANGEMENTS

KTI leases facilities from the University's Advanced Science and Technology Commercialization Center (ASTeCC) and Agricultural Technologies Commercialization Center (AgTeCC). The leases automatically renew annually. Rent expense for these facilities was \$93,497 and \$82,071 for the periods ended December 31, 2011 and December 31, 2010, respectively. KTI subleases the ASTeCC and AgTeCC buildings to developing industries in advanced technology, with renewal options and escalation clauses. Sublease rental income was \$162,945 (including \$29,371 from the University's College of Engineering) and \$151,042 (including \$39,608 from the University's College of Engineering) for the periods ended December 31, 2011 and December 31, 2010, respectively. Future minimum rental revenue at December 31, 2011 is \$103,043 for the year ending December 31, 2012.

KTI leases space in the Coldstream Center on the Coldstream Research Campus under a long-term lease terminating in the year 2016. Rental expense was \$358,332 for both of the periods ended December 31, 2011 and December 31, 2010. Following is a schedule of minimum lease payments related to this lease for future fiscal years:

Year ending December 31,	
2012	\$ 330,953
2013	317,263
2014	317,263
2015	317,263
2016	52,877
Total minimum lease payments	<u>\$ 1,335,619</u>

KTI is also responsible for 26.84% of actual expenses related to common area maintenance, utilities and property taxes. This amounted to \$233,571 and \$295,088 during the periods ended December 31, 2011 and December 31, 2010, respectively.

KTI subleases office and laboratory space to tenants in the Coldstream Center with leases running from six months to five years, with options to renew for one to three years. Rental income was \$736,615 (including \$195,668 from CLI and \$53,370 from UK Coldstream Research Center Administration) and \$406,195 (including \$179,702 from CLI and \$53,370 from UK Coldstream Research Center Administration) for the periods ended December 31, 2011 and December 31, 2010, respectively. The following is a schedule of future minimum rental receipts to be received under the leases at December 31, 2011:

Year ending December 31,	
2012	\$ 394,572
2013	245,451
2014	83,278
Total minimum rental receipts	<u>\$ 723,301</u>

KTI's wholly owned subsidiary, Secat, Inc., leases property from the University at no charge. The fair market value of this lease is approximately \$250,000 per year, which has been included as both in-kind revenue and expense on the Foundation's Statement of Revenues, Expenses, and Changes in Net Assets.

CLI leases its manufacturing facility from the University under an operating lease with an initial term of ten years, having two additional five-year renewal options. Recognized rent expense is \$433,674 and \$433,674 for the periods ended December 31, 2011 and December 31, 2010, respectively. CLI also leases its labs in the Coldstream Center Building from KTI and 150 Bull Lea, an unrelated third party. The lease terms range from 2 to 5 years, with monthly rent ranging from \$1,073 to \$7,068. Future minimum lease payments related to this lease as of December 31, 2011 are as follows:

Year ending December 31,	
2012	\$ 704,291
2013	575,001
2014	462,250
2015	433,674
2016	433,674
2017	180,699
Total minimum lease payments	<u>\$ 2,789,589</u>

14. RECLASSIFICATIONS

Certain reclassifications to fiscal year 2011 comparative amounts have been made to conform to the fiscal year 2012 financial statement classifications. Certain transactions previously reported as an investment in stock are now being reported as an investment in pooled equity. Such classifications had no effect on the change in net assets.

15. CURRENT ECONOMIC CONDITIONS

The current economic situation continues to present not-for-profit organizations with difficult circumstances and challenges, which in some cases have resulted in large declines in grant funding. These conditions have made it difficult for many sponsors to continue to contribute to research at not-for-profit organizations. A significant decline in revenue from sponsors for grants could have an adverse impact on the Foundation's future operating results. The financial statements have been prepared using values and information currently available to the Foundation.

UNIVERSITY OF KENTUCKY RESEARCH FOUNDATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENT OF NET ASSETS SCHEDULE
JUNE 30, 2012

	University of Kentucky Research Foundation	Kentucky Technology, Inc.	Coldstream Laboratories, Inc.	Elimination Entries	Total
ASSETS					
Current Assets					
Cash and cash equivalents	\$ 35,355,795	\$ 1,331,963	\$ 25,001		\$ 36,712,759
Accounts receivable	41,460,735	196,443	1,705,417	\$ (18,687)	43,343,908
Investments			351,250		351,250
Other current assets, net	1,610,470	185,621	665,780		2,461,871
Total current assets	<u>78,427,000</u>	<u>1,714,027</u>	<u>2,747,448</u>	<u>(18,687)</u>	<u>82,869,788</u>
Noncurrent Assets					
Endowment investments	3,598,169				3,598,169
Other long-term investments	11,805,469	1,468,333		(11,801,528)	1,472,274
Other noncurrent assets, net				2,250,000	2,250,000
Capital assets, net	2,781,574	6,887,229	5,422,751		15,091,554
Total noncurrent assets	<u>18,185,212</u>	<u>8,355,562</u>	<u>5,422,751</u>	<u>(9,551,528)</u>	<u>22,411,997</u>
Total assets	<u>96,612,212</u>	<u>10,069,589</u>	<u>8,170,199</u>	<u>(9,570,215)</u>	<u>105,281,785</u>
LIABILITIES					
Current Liabilities					
Accounts payable and accrued liabilities	14,297,191	558,292	2,978,143	(18,687)	17,814,939
Deferred revenue	31,521,248	634,063	1,643,595		33,798,906
Due to affiliated corporations	3,520,141				3,520,141
Long-term liabilities - current portion		74,223	1,021,929		1,096,152
Total current liabilities	<u>49,338,580</u>	<u>1,266,578</u>	<u>5,643,667</u>	<u>(18,687)</u>	<u>56,230,138</u>
Noncurrent Liabilities					
Long term liabilities		870,877	907,138		1,778,015
Total noncurrent liabilities	<u>-</u>	<u>870,877</u>	<u>907,138</u>	<u>-</u>	<u>1,778,015</u>
Total liabilities	<u>49,338,580</u>	<u>2,137,455</u>	<u>6,550,805</u>	<u>(18,687)</u>	<u>58,008,153</u>
NET ASSETS					
Invested in capital assets, net of related debt	<u>2,781,574</u>	<u>6,813,006</u>	<u>4,312,559</u>		<u>13,907,139</u>
Restricted					
Nonexpendable	754,509				754,509
Expendable	3,510,103				3,510,103
Total restricted	<u>4,264,612</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,264,612</u>
Unrestricted	<u>40,227,446</u>	<u>1,119,128</u>	<u>(2,693,165)</u>	<u>(9,551,528)</u>	<u>29,101,881</u>
Total net assets	<u>\$ 47,273,632</u>	<u>\$ 7,932,134</u>	<u>\$ 1,619,394</u>	<u>\$ (9,551,528)</u>	<u>\$ 47,273,632</u>

UNIVERSITY OF KENTUCKY RESEARCH FOUNDATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS SCHEDULE
FOR THE YEAR ENDED JUNE 30, 2012

	University of Kentucky Research Foundation	Kentucky Technology, Inc.	Coldstream Laboratories, Inc.	Elimination Entries	Total
OPERATING REVENUES					
Federal grants and contracts	\$ 178,607,378	\$ 5,832			\$ 178,613,210
State and local grants and contracts	73,843,119				73,843,119
Nongovernmental grants and contracts	26,670,381	1,374,971			28,045,352
Recoveries of facilities and administrative costs	51,542,511				51,542,511
Other operating revenues	283,688	1,345,381	\$ 8,796,612	\$ (195,668)	10,230,013
Total operating revenues	<u>330,947,077</u>	<u>2,726,184</u>	<u>8,796,612</u>	<u>(195,668)</u>	<u>342,274,205</u>
OPERATING EXPENSES					
Educational and general:					
Instruction	12,728,620				12,728,620
Research	170,804,627	2,616,496		(28,253)	173,392,870
Public service	120,077,321		12,894,568	(195,668)	132,776,221
Academic support	2,678,591				2,678,591
Student services	30,663				30,663
Institutional support	995,961				995,961
Operations and maintenance of plant	453,220				453,220
Student financial aid	1,718,883				1,718,883
Depreciation	24,060	425,035	978,294		1,427,389
Total operating expenses	<u>309,511,946</u>	<u>3,041,531</u>	<u>13,872,862</u>	<u>(223,921)</u>	<u>326,202,418</u>
Net income (loss) from operations	<u>21,435,131</u>	<u>(315,347)</u>	<u>(5,076,250)</u>	<u>28,253</u>	<u>16,071,787</u>
NONOPERATING REVENUES (EXPENSES)					
Gifts	130,600				130,600
Investment income (loss)	(4,969,008)	168,857	2,376	5,001,011	203,236
Patent income	1,263,082				1,263,082
Grant (to) from the University of Kentucky for noncapital purposes	(8,570,181)				(8,570,181)
Interest on capital asset-related debt			(76,822)		(76,822)
Other nonoperating revenues and expenses, net	1,896	47,558	641	(28,253)	21,842
Net nonoperating revenues (expenses)	<u>(12,143,611)</u>	<u>216,415</u>	<u>(73,805)</u>	<u>4,972,758</u>	<u>(7,028,243)</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>9,291,520</u>	<u>(98,932)</u>	<u>(5,150,055)</u>	<u>5,001,011</u>	<u>9,043,544</u>
Capital grants and gifts	22,741,686	729,540			23,471,226
Additions to permanent endowments	2,255				2,255
Grant (to) from the University of Kentucky for capital purposes	(28,367,418)				(28,367,418)
Capital contributions from the foundation			5,443,453	(5,443,453)	-
Other, net		(481,564)			(481,564)
Total other revenues (expenses)	<u>(5,623,477)</u>	<u>247,976</u>	<u>5,443,453</u>	<u>(5,443,453)</u>	<u>(5,375,501)</u>
INCREASE (DECREASE) IN NET ASSETS	<u>3,668,043</u>	<u>149,044</u>	<u>293,398</u>	<u>(442,442)</u>	<u>3,668,043</u>
NET ASSETS, beginning of year	43,605,589	7,783,090	1,325,996	(9,109,086)	43,605,589
NET ASSETS, end of year	<u>\$ 47,273,632</u>	<u>\$ 7,932,134</u>	<u>\$ 1,619,394</u>	<u>\$ (9,551,528)</u>	<u>\$ 47,273,632</u>

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