



Financial Statements

for

**KENTUCKY MEDICAL
SERVICES FOUNDATION, INC.**

*Years Ended June 30, 2021 and 2020
with Report of Independent Auditors*

CONTENTS

	<u>Pages</u>
Report of Independent Auditors.....	1 - 2
Financial Statements:	
Balance Sheets.....	3 - 4
Statements of Operations and Changes in Net Assets.....	5
Statements of Functional Expenses.....	6
Statements of Cash Flows.....	7 - 8
Notes to the Financial Statements.....	9 - 24

Report of Independent Auditors

To the Board of Directors of
Kentucky Medical Services Foundation, Inc.
Lexington, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of Kentucky Medical Services Foundation, Inc. (KMSF) which comprise the balance sheets as of June 30, 2021 and 2020, the related statements of operations and changes in net assets, functional expenses and cash flows for the years then ended, and the related notes to the 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.

To the Board of Directors of
Kentucky Medical Services Foundation, Inc.
Report of Independent Auditors, continued

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Medical Services Foundation, Inc. as of June 30, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the financial statements, effective July 1, 2020, KMSF adopted Accounting Standards Update (2014-09), *Revenue from Contracts with Customers (Topic 606)*. Our opinion is not modified with respect to this matter.

Dean Dotson Allen Ford, PLLC

Lexington, Kentucky
September 17, 2021

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Balance Sheets

June 30, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Assets		
Current assets:		
Investments and interest bearing deposits, current portion	\$ 49,222,676	\$ 16,118,797
Patient accounts receivable, less allowance for uncollectibles of \$11,481,974 and \$9,900,935 and allowances for contractual adjustments of \$74,788,165 and \$66,316,651 in 2021 and 2020, respectively	37,817,297	36,187,135
Accounts receivable - Physician Supplemental Payment (PSP)/Directed Payment revenue	13,355,880	22,263,883
Other receivables, current portion	6,189,034	2,543,420
Other current assets	<u>1,195,181</u>	<u>1,393,677</u>
Total current assets	107,780,068	78,506,912
Assets limited as to use:		
Dean's academic enrichment funds - limited by agreement	14,243,993	9,700,820
Investments and interest bearing deposits, less current portion	50,056,375	43,892,356
Other receivables, less current portion	731,441	607,883
Property and equipment:		
Land and improvements	3,331,198	3,058,102
Buildings	62,579,066	54,468,638
Furniture and equipment	9,291,364	9,484,367
Capitalized software	16,986,574	16,986,574
Buildings under capital lease obligations	71,165,295	71,165,295
Equipment under capital lease obligations	1,221,032	1,365,107
Construction in progress	<u>2,542,334</u>	<u>4,114,263</u>
	167,116,863	160,642,346
Less accumulated depreciation	<u>65,179,380</u>	<u>55,078,698</u>
Net property and equipment	<u>101,937,483</u>	<u>105,563,648</u>
Total assets	<u>\$274,749,360</u>	<u>\$238,271,619</u>

	<u>2021</u>	<u>2020</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 8,092,938	\$ 13,872,010
Long-term debt, current portion	823,452	799,123
Capital leases, current portion	3,530,879	3,288,100
Settlements due to third party payors	569,474	625,219
Patient refunds	1,970,946	1,532,319
Due to the University of Kentucky	583,348	32,021,461
Due to the University of Kentucky - malpractice fund	29,820,301	23,656,283
Due to the College of Medicine departments under departmental plan agreements	<u>131,774,870</u>	<u>61,000,679</u>
Total current liabilities	177,166,208	136,795,194
Long-term debt, net of current portion	15,671,955	16,495,408
Capital leases, net of current portion	<u>55,282,090</u>	<u>58,812,964</u>
Total long-term liabilities	<u>70,954,045</u>	<u>75,308,372</u>
Total liabilities	248,120,253	212,103,566
Net assets without donor restrictions:		
Board designated - property and equipment (net of long-term debt and capital leases)	<u>26,629,107</u>	<u>26,168,053</u>
Total liabilities and net assets	<u>\$274,749,360</u>	<u>\$238,271,619</u>

See accompanying notes.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Statements of Operations and Changes in Net Assets

Years ended June 30, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Revenues and gains:		
Net professional clinical service fee revenue	\$252,822,975	\$232,512,821
Capitation revenue	<u>26,500,561</u>	<u>27,032,886</u>
Net professional clinical service fee revenue and capitation revenue	279,323,536	259,545,707
Lease income	9,496,755	6,791,929
Investment income, net	204,017	449,109
PSP/Directed Payment revenue	86,051,793	85,481,869
Cares Act revenue	-	2,363,742
Other income, net	<u>23,804,758</u>	<u>23,447,220</u>
Total revenues and gains	398,880,859	378,079,576
Expenses:		
Departmental expenses	348,778,929	327,068,498
Operating expenses - business office	7,075,086	6,601,740
UKHMO capitation expenses	7,501,839	6,332,193
Reimbursement to the University of Kentucky for malpractice insurance and expenses attendant to the production of clinical income	6,768,242	5,372,981
Dean's academic enrichment funds	10,316,474	16,689,285
Physicians' fringe benefits	3,591,026	3,785,127
Depreciation expense	10,785,190	9,133,897
Interest expense	3,556,915	4,963,277
Bad debts	<u>46,104</u>	<u>23,672</u>
Total expenses	398,419,805	<u>379,970,670</u>
Change in net assets	461,054	(1,891,094)
Net assets, beginning of year	<u>26,168,053</u>	<u>28,059,147</u>
Net assets, end of year	\$ <u>26,629,107</u>	\$ <u>26,168,053</u>

See accompanying notes.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Statements of Functional Expenses

Years ended June 30, 2021 and 2020

2021

	UK Healthcare Mission	UK HMO	Administrative	Total
Salaries and wages	\$ 208,713,301	\$ 407,894	\$ 2,170,753	\$ 211,291,948
Fringe benefits	19,589,821	90,821	701,849	20,382,491
Purchased services	6,007,525	7,501,839	1,835,205	15,344,569
Supplies	8,453,193	-	239,035	8,692,228
Malpractice expenses	6,768,242	-	-	6,768,242
Rent and lease expenses	1,786,340	-	-	1,786,340
Utilities	1,194,484	-	207,621	1,402,105
Maintenance and repairs	1,375,166	-	6,212	1,381,378
Interest expense	3,556,915	-	-	3,556,915
Depreciation	6,517,995	-	4,267,195	10,785,190
Bad debts	46,104	-	-	46,104
Other expenses	<u>116,969,061</u>	<u>108,305</u>	<u>(95,071)</u>	<u>116,982,295</u>
Total expenses	<u>\$ 380,978,147</u>	<u>\$ 8,108,859</u>	<u>\$ 9,332,799</u>	<u>\$ 398,419,805</u>

2020

	UK Healthcare Mission	UK HMO	Administrative	Total
Salaries and wages	\$ 214,152,882	\$ 415,258	\$ 2,386,056	\$ 216,954,196
Fringe benefits	41,706,178	102,037	725,364	42,533,579
Purchased services	5,352,600	6,332,193	1,071,616	12,756,409
Supplies	9,019,930	185	178,693	9,198,808
Malpractice expenses	5,372,981	-	-	5,372,981
Rent and lease expenses	1,874,285	-	-	1,874,285
Utilities	1,157,040	-	205,332	1,362,372
Maintenance and repairs	1,286,654	-	6,102	1,292,756
Interest expense	4,962,191	-	1,086	4,963,277
Depreciation	6,138,689	-	2,995,208	9,133,897
Bad debts	23,672	-	-	23,672
Other expenses	<u>74,334,521</u>	<u>169,917</u>	<u>-</u>	<u>74,504,438</u>
Total expenses	<u>\$ 365,381,623</u>	<u>\$ 7,019,590</u>	<u>\$ 7,569,457</u>	<u>\$ 379,970,670</u>

See accompanying notes.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Statements of Cash Flows

Years ended June 30, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Cash flows from operating activities:		
Change in net assets	\$ 461,054	\$ (1,891,094)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation	10,785,190	9,133,897
Gain on disposal of assets	(121,747)	(3,015)
Provision for bad debts	46,104	23,672
Amortization of loan fees	5,943	5,943
Increase (decrease) in cash due to changes in:		
Patient accounts receivable	(1,676,266)	1,482,073
Accounts receivable - PSP/Directed Payment revenue	8,908,003	(13,827,014)
Other receivables	(3,769,172)	(159,599)
Other current assets	198,496	143,621
Accounts payable and accrued liabilities	(5,779,072)	2,813,420
Settlements due to third party payors	(55,745)	55,745
Patient refunds	438,627	(974,827)
Due to the University of Kentucky	(31,438,113)	(1,118,726)
Due to the University of Kentucky - malpractice fund	6,164,018	836,381
Due to the College of Medicine departments under departmental plan agreements	<u>70,774,191</u>	<u>21,272,842</u>
Net cash provided by operating activities	54,941,511	17,793,319
Cash flows from investing activities:		
Capital expenditures	(7,564,653)	(4,630,065)
Increase in investments and interest-bearing deposits, net	(39,267,898)	(12,847,623)
(Increase) decrease in assets limited as to use, net	(4,543,173)	2,300,035
Proceeds on sale of property and equipment	<u>527,375</u>	<u>4,000</u>
Net cash used in investing activities	(50,848,349)	(15,173,653)
Cash flows from financing activities:		
Repayments on long-term debt	(805,067)	(780,041)
Payments on capital leases	<u>(3,288,095)</u>	<u>(1,839,625)</u>
Net cash used in financing activities	(4,093,162)	(2,619,666)
Net change in cash	\$ <u>-</u>	\$ <u>-</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Statements of Cash Flows, continued

Years ended June 30, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Supplemental cash flow disclosures:		
Cash paid for interest	\$ 3,556,915	\$ 4,963,277
Noncash investing and financing transactions:		
Capital lease obligation amendment	\$ -	\$ 5,397,036

See accompanying notes.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements

1. Description of the Organization

Kentucky Medical Services Foundation, Inc. (KMSF) is a non-profit, non-stock corporation. KMSF has been assigned the responsibility to bill, collect and administer all clinical income generated by the physicians of the University of Kentucky (UK) College of Medicine (the College) in accordance with an annual agreement (the Agreement) between KMSF and UK regarding the operation of KMSF. The Agreement was last renewed on July 1, 2021.

Although included in UK's audited financial statements according to *Governmental Accounting Standards*, KMSF is not considered to be an affiliate of UK by Kentucky Revised Statute.

2. Summary of Significant Accounting Policies

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) which required management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The Financial Accounting Standards Board (FASB) promulgates its Accounting Standards Codification as the only source of authoritative accounting principles recognized by the FASB to be applied to nongovernmental entities in the preparation of financial statements in conformity with GAAP. The following is a summary of the significant accounting policies consistently followed by KMSF in the preparation of its financial statements:

Adoption of Recently Issued Accounting Standards

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The ASU and all subsequently issued clarifying ASUs replaced most existing revenue recognition guidance in GAAP. The ASU also required expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

KMSF adopted the new standard effective July 1, 2020, the first day of KMSF's fiscal year using the modified retrospective approach and applied to all uncompleted contracts. As a result, the majority of what was previously classified as the provision for bad debts is now reflected as implicit price concessions (as defined in Topic 606) and included as a reduction to net professional clinical service fee revenue. Additionally, the allowance for doubtful accounts of approximately \$9,900,000 as of July 1, 2020 was reclassified as a component of patient accounts receivable. Other than these changes in presentation on the related statements, the adoption of Topic 606 did not have a material impact on the statement of operations and changes in net assets for the year ended June 30, 2020, and KMSF does not expect it to have a material impact on its statement of income on a prospective basis. For comparative purposes, KMSF reclassified these items for 2020.

As part of the adoption of Topic 606, KMSF elected the following practical expedients as follows:

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Adoption of Recently Issued Accounting Standards, continued

- KMSF applied the modified retrospective method upon adoption of Topic 606, which allowed the new accounting standard to be applied only to contracts that were not considered substantially complete as of July 1, 2020.
- Contract prices are not adjusted for the effects of a significant financing component as KMSF expects, at contract inception, that the period between when KMSF transfers a service to a customer and when the customer pays for that service will be one year or less.
- KMSF has elected to apply the portfolio approach to the contracts evaluated under ASC Topic 606. A portfolio approach is permitted if it is reasonably expected that the approach's impact on the financial statements will not be materially different from the impact of applying the revenue standard on an individual contract basis. In order to use the portfolio approach, an entity must reasonably expect that the accounting result will not be materially different from the result of applying the standard to the individual contracts

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis. Under the terms of the various departmental plans and the Agreement with UK, all income from operations of KMSF, exclusive of changes in the net book value of property and equipment, debt acquired for purchase of property and equipment and changes in amounts designated by the Board of Directors for specific purposes, are payable to the participating departments. Accordingly, such amounts have been included as departmental expenses in the accompanying statements of operations and changes in net assets.

Assets Limited as to Use

Assets limited as to use include cash and investments set aside by the Board of Directors for specific purposes over which the Board retains control and may, at its discretion, subsequently use for other purposes, if any, and cash and investments set aside in accordance with the Agreement between KMSF and UK (see Note 5.).

Property and Equipment

KMSF capitalizes all expenditures of \$5,000 or more for moveable equipment and of \$10,000 or more for buildings and building improvements, fixed equipment, infrastructure assets and land improvements. Property and equipment purchased are recorded at cost at the date of acquisition. Depreciation is computed using the straight-line method over the estimated useful life of the depreciable assets, or if leased, the shorter of estimated useful life or leased period, which range from three to forty years. Donated property and equipment, if any, are recorded at estimated fair value at the date of donation.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Income Tax Exemption

KMSF is a non-profit corporation as described in Section 501(c)(3) of the *Internal Revenue Code* (the Code) and is exempt from federal income taxes on related income.

Patient Accounts Receivable and Net Professional Clinical Service Fees

Net professional clinical service fees and patient accounts receivable are reported at the amount that reflects the consideration to which KMSF expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government payors), and others. Generally, KMSF bills the patients and third-party payors several days after the services are performed. Revenue is recognized as the performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by KMSF. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. KMSF believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in KMSF receiving inpatient acute care services. KMSF measures the performance obligation from admission to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Outpatient service revenue is recognized at a point in time when services are provided and KMSF does not believe it is required to provide additional goods or services to the patient.

KMSF estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions based on historical collection experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Agreements with third-party payors provide for payments at amounts less than established charges. Payment agreements with governments and commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges, and prospectively determined rates. Generally patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Patient Accounts Receivable and Net Professional Clinical Service Fees, continued

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and potential exclusion from related programs. There can be no assurance that regulatory authorities will not challenge KMSF's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon KMSF.

Consistent with KMSF's mission, care is provided to patients regardless of their ability to pay. Therefore, KMSF has determined it has provided implicit price concessions to uninsured patients and other uninsured balances, (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represents the difference between amounts billed to patients and the amounts KMSF expects to collect based on its collection history with those patients.

Charity Care

UK provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because UK does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care charges totaled \$5,246,626 and \$10,855,313 in 2021 and 2020, respectively. Management has estimated its cost incurred to provide charity care to be approximately \$1,700,000 and \$4,300,000 for the years ended June 30, 2021 and 2020, respectively.

Investments and Investment Income

KMSF has investments in certificates of deposit and other interest bearing deposits, government securities, guaranteed investment contracts and mutual funds as permitted by the Agreement with UK. These investments are stated at fair value or carrying amounts that approximate fair value.

Investment income (including realized and unrealized gains and losses on investments, interest and dividends) is considered by management to be essential to the ongoing operations of KMSF and is reported as other operating revenue.

Functional Allocation of Expenses

The costs of program and supporting services activities have been summarized on a functional basis in the statements of operations and changes in net assets. The statements of functional expenses presents the natural classification detail of expenses by function. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

COVID-19

In March 2020, the World Health Organization declared the coronavirus (COVID-19) outbreak to be a pandemic. COVID-19 continues to spread across the globe and is impacting worldwide economic activity and financial markets. The continued spread of the disease represents a significant risk that operations could be disrupted in the near future. The extent to which COVID-19 impacts KMSF will depend on future developments, which are highly uncertain and cannot be predicted. As a result, KMSF has not yet determined the impact this disruption may have on their financial statements for the year ending June 30, 2022.

Reclassification

Certain 2020 amounts have been reclassified to conform with current year presentation with no effect on total assets, liabilities, net assets, and change in net assets.

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through September 17, 2021, the date that the financial statements were available to be issued.

New Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, requiring all leases to be recognized on KMSF's balance sheet as a right-of-use asset and a lease liability, unless the lease is a short term lease (generally a lease with a term of twelve months or less). At the commencement date of the lease, KMSF will recognize: 1) a lease liability for Hospital's obligation to make payments under the lease agreement, measured on a discounted basis; and 2) a right-of-use asset that represents KMSF's right to use, or control the use of, the specified asset for the lease term. The ASU originally required recognition and measurement of leases at the beginning of the earliest period presented using a modified retrospective transition method. In July 2018, the FASB issued ASU 2018-11, which provided an additional (and optional) transition method that permits application of the updated standard at the adoption date with recognition of a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. In June 2020, the FASB issued ASU 2020-05, which deferred the effective date of ASU 2016-02. The updated standard will be effective for KMSF for the year ending June 30, 2023, with early adoption permitted. KMSF has not yet selected a transition method and is currently evaluating the effect that the new standard will have on its financial statements.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

3. Liquidity and Availability

The following table reflects KMSF's current financial assets as of June 30, 2021 and 2020, reduced by amounts that are not available to meet general expenditures within one year of the statement of financial position date because of contractual restrictions or internal board designations. There were no net assets with donor restrictions at June 30, 2021 and 2020.

	<u>2021</u>	<u>2020</u>
Investments and interest bearing deposits, current portion	\$ 49,222,676	\$ 16,118,797
Patient accounts receivable, net	37,817,297	36,187,135
Accounts receivable - Physician Supplemental Payment (PSP) revenue	13,355,880	22,263,883
Other receivables, current portion	6,189,034	2,543,420
Other current assets	<u>1,195,181</u>	<u>1,393,677</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 107,780,068</u>	<u>\$ 78,506,912</u>

KMSF has approximately \$20,000,000 in short-term certificates of deposit with maturity terms varying between one week and four months. These are classified under long-term investments; however, they are available to be redeemed if necessary to meet general expenditures within one year.

KMSF also maintains a designated investment portfolio for the malpractice fund. The market value of the portfolio as of June 30, 2021 and 2020 was \$29,820,301 and \$23,656,283, respectively. The portfolio is classified under long-term investments on the financial statements, however, it is available to meet the financial obligation due to the University of Kentucky for the Malpractice Fund, listed at an equal value within current liabilities.

4. Other Receivables

KMSF makes loans to physicians they anticipate will become employees of UK. A portion of these loans will be forgiven each year, up to the maximum amount of the loan, if certain conditions, such as serving as a full-time physician and faculty member of UK, are met by the borrower. If the conditions for forgiveness are not met, the entire principal balance is payable by the borrower, including accrued interest at the rate of 1% above prime. The total amount outstanding on such loans was \$1,201,217 and \$1,077,824 as of June 30, 2021 and 2020, respectively.

5. Academic Enrichment Funds

In accordance with the Agreement with UK effective July 1, 2020 and the Agreement with UK effective July 1, 2019, KMSF is required to maintain a separate bank account, which represents a specified percentage of cumulative clinical income collected, less cumulative disbursements by the Dean of the College of Medicine. The percentage of collections added to this account was 8% in both 2021 and 2020.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

5. Academic Enrichment Funds, continued

The funds in the account are for the use of the Dean of the College of Medicine for the enrichment of the program of the College or for related purposes at his/her sole discretion. The Dean's Fund supports the missions of UK and UK HealthCare by providing financial support of activities such as research, education, departmental and program development. In 2021 and 2020, the amount provided to UK for research and education was \$10,316,474 and \$16,689,285, respectively. In 2021 and 2020, \$996,937 and \$955,167, respectively, of such funds were expended in the Dean's operations for faculty and staff salaries, benefits and other operating expenses and are included in departmental expenses.

The cash balance in the dean's account as of June 30, 2021 and 2020 was \$14,243,993 and \$9,700,820 respectively, and is included as part of the liability payable under the Departmental Plan Agreements.

6. Investments and Interest Bearing Deposits

Investments and interest bearing deposits, including accrued interest, are as follows as of June 30:

	<u>2021</u>	<u>2020</u>
Interest bearing deposits and government securities	\$ 69,666,532	\$ 36,453,732
Fixed income securities	8,099,752	6,843,733
Equity securities and equity security mutual funds	<u>21,512,767</u>	<u>16,713,688</u>
Total investments and interest bearing deposits	<u>\$ 99,279,051</u>	<u>\$ 60,011,153</u>

The components of investment income from investments and interest bearing deposits for 2021 and 2020 consist of \$204,017 and \$449,109, respectively, of realized and unrealized gains and losses, dividends and interest.

Management has elected to follow Accounting Research Bulletin 43 in the presentation of current and non-current investments as follows:

	<u>2021</u>	<u>2020</u>
Current investments	\$ 49,222,676	\$ 16,118,797
Non-current investments	<u>50,056,375</u>	<u>43,892,356</u>
Total investment and interest bearing deposits	<u>\$ 99,279,051</u>	<u>\$ 60,011,153</u>

7. Fair Value Measurements

KMSF classifies its investments based on a hierarchy consisting of: Level 1 (valued using quoted prices from active markets for identical assets), Level 2 (not traded on an active market but for which observable market inputs are readily available), and Level 3 (valued based on significant unobservable inputs). The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

7. Fair Value Measurements, continued

Following is a description of the valuation methodologies used for assets measured at fair value on a recurring basis:

Interest bearing deposits and government securities: Valued at cost which approximates fair value.

Common stocks and foreign equities: Valued at the closing price reported on the active market on which the individual securities are traded.

Real estate investment partnership: Valued at cost, which approximates fair value.

Real estate investment trust: Valued at the closing price reported on the active market on which the individual securities are traded.

Mutual funds: Mutual funds based in equity securities are valued at the daily closing price as reported by the fund. These mutual funds held by KMSF are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. These mutual funds are deemed to be actively traded.

Fixed income securities: Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.

There have been no changes in the valuation methodologies used at June 30, 2021 and 2020.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while KMSF's management believes the valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

7. Fair Value Measurements, continued

The following tables set forth by level, within the fair value hierarchy, KMSF's assets and liabilities at fair value:

<u>June 30, 2021</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Interest bearing deposits and government securities	\$ 69,666,532	\$ -	\$ -	\$ 69,666,532
Common stocks and foreign equities	12,463,883	-	-	12,463,883
Real estate investment trust	342,320	-	-	342,320
Real estate investment partnership	-	853,896	-	853,896
Mutual funds :				
Taxable/fixed income	4,558,325	-	-	4,558,325
International	5,327,713	-	-	5,327,713
Mid cap	1,270,397	-	-	1,270,397
Small cap	<u>1,254,558</u>	<u>-</u>	<u>-</u>	<u>1,254,558</u>
Total mutual funds	12,410,993	-	-	12,410,993
Fixed income securities :				
Aaa credit rating	-	1,092,410	-	1,092,410
Aa2 credit rating	-	693,021	-	693,021
Aa3 credit rating	-	726,380	-	726,380
A1 credit rating	-	376,993	-	376,993
A2 credit rating	-	263,520	-	263,520
A3 credit rating	-	288,096	-	288,096
NR credit rating	<u>-</u>	<u>101,007</u>	<u>-</u>	<u>101,007</u>
Total fixed income securities	<u>-</u>	<u>3,541,427</u>	<u>-</u>	<u>3,541,427</u>
Total investments	<u>\$ 94,883,728</u>	<u>\$ 4,395,323</u>	<u>\$ -</u>	<u>\$ 99,279,051</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

7. Fair Value Measurements, continued

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>June 30, 2020</u>				
Interest bearing deposits and government securities	\$ 36,453,732	\$ -	\$ -	\$ 36,453,732
Common stocks and foreign equities	9,682,763	-	-	9,682,763
Real estate investment trust	1,364,694	-	-	1,364,694
Real estate investment partnership	-	840,109	-	840,109
Mutual funds :				
Taxable/fixed income	3,722,055	-	-	3,722,055
International	3,387,455	-	-	3,387,455
Mid cap	956,296	-	-	956,296
Small cap	<u>482,371</u>	<u>-</u>	<u>-</u>	<u>482,371</u>
Total mutual funds	8,548,177	-	-	8,548,177
Fixed income securities :				
Aaa credit rating	-	1,132,348	-	1,132,348
Aa2 credit rating	-	105,469	-	105,469
Aa3 credit rating	-	292,057	-	292,057
A1 credit rating	-	374,796	-	374,796
A2 credit rating	-	531,066	-	531,066
A3 credit rating	-	491,334	-	491,334
Baa1 credit rating	-	95,632	-	95,632
NR credit rating	<u>-</u>	<u>98,976</u>	<u>-</u>	<u>98,976</u>
Total fixed income securities	<u>-</u>	<u>3,121,678</u>	<u>-</u>	<u>3,121,678</u>
Total investments	<u>\$ 56,049,366</u>	<u>\$ 3,961,787</u>	<u>\$ -</u>	<u>\$ 60,011,153</u>

To assess the appropriate classification of assets and liabilities within the fair value hierarchy, the availability of market data is monitored. Changes in economic conditions or valuation techniques may require the transfer of assets and liabilities from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period. KMSF's management evaluates the significance of transfers between levels based upon the nature of the assets and liabilities and size of the transfer relative to total net assets. There were no transfers of assets or liabilities from one fair value level to another during the years ended June 30, 2021 and 2020.

8. Settlements Due to Third Party Payors

KMSF has accrued settlements due to third party payors of approximately \$570,000 and \$625,000 as of June 30, 2021 and 2020, respectively. This liability represents amounts due to the federal government and insurance companies for payments KMSF has received but which need to be refunded due to various reasons within the revenue cycle.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

9. Long-Term Debt and Capital Leases

As of June 30, 2021 and 2020, notes payable and capital lease obligations consisted of the following:

	<u>2021</u>	<u>2020</u>
Capital lease obligation, maturing August 2034, bearing interest at 5.0%, collateralized by property with a net book value of \$29,468,072, payments of \$258,768 per month (payment amounts increase annually as defined by the agreement).	\$ 31,903,971	\$ 33,352,194
Capital lease obligation, maturing March 2037, bearing interest at 4.75% for the base rent, and 7.5% for the tenant improvements portion, collateralized by property with a net book value of \$13,499,896, payments of \$111,181 per month (payment amounts per month increase every fifth year of the capital lease obligation).	15,446,853	15,892,289
County of Clark, Kentucky Healthcare Revenue Bonds, Series 2017, accruing interest at a rate equal to 2.94% as of June 30, 2021, due in monthly principal and interest payments of \$55,374 and maturing in April 2037.	8,377,569	8,785,700
County of Scott, Kentucky Healthcare Revenue Bonds, Series 2017, accruing interest at a rate equal to 2.94% as of June 30, 2021, due in monthly principal and interest payments of \$54,016 and maturing in April 2037.	8,212,440	8,609,376
Capital lease obligation, maturing June 2027, bearing interest at 4.25%, collateralized by property with a net book value of \$4,946,229, payments of \$91,822 per month (increasing by 2% every subsequent lease year).	6,110,772	6,912,745
Capital lease obligation, maturing June 2028, bearing interest at 4.25%, collateralized by property with a net book value of \$4,664,421, payments of \$67,662 per month (increasing by 2.75% every subsequent lease year). KMSF has the option to renew for three additional five year lease terms.	5,308,250	5,860,077

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

9. Long-term Debt and Capital Leases, continued

	<u>2021</u>	<u>2020</u>
Capital lease obligations at varying rates of interest from 0.35% to 5.50%, collateralized by leased equipment with a net book value of \$166,130 at June 30, 2021.	<u>43,123</u>	<u>83,759</u>
Total long-term debt	75,402,978	79,496,140
Less capitalized loan fees, net	<u>94,602</u>	<u>100,545</u>
	75,308,376	79,395,595
Less current portion	<u>4,354,331</u>	<u>4,087,223</u>
Long-term debt, net of current portion	<u>\$ 70,954,045</u>	<u>\$ 75,308,372</u>

Scheduled principal repayments on bonds and payments on capital lease obligations are as follows:

Year ending June 30,	<u>Bonds</u>	<u>Capital Lease Obligations</u>
2022	\$ 829,395	\$ 6,412,030
2023	854,459	6,543,209
2024	879,101	6,620,845
2025	906,845	6,690,336
2026	934,249	6,774,041
Thereafter	<u>12,185,960</u>	<u>47,763,182</u>
	<u>\$ 16,590,009</u>	80,803,643
Less amount representing interest under capital lease obligations		<u>21,990,674</u>
		<u>\$ 58,812,969</u>

Interest expense was \$3,556,915 and \$4,963,277 for the years ended June 30, 2021 and 2020, respectively.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

10. Net Professional Clinical Service Fees and Capitation Revenue

UK and KMSF have agreements with third-party payors that provide for payments at amounts different from their established rates. Contractual adjustments represent the difference between billing at established rates and amounts reimbursed by third-party payors.

Revenue recognized at a point in time includes capitation revenue, PSP/directed payment revenue, retail drug sales, and other revenues. Revenue recognized over time include professional clinical service fee revenue (including associated drug sales).

Net revenue recognized by timing of revenue recognition for the years ended June 30, 2021 and 2020, is as follows:

	<u>2021</u>	<u>2020</u>
Revenue recognized at a point in time	\$ 140,774,265	\$ 139,963,395
Revenue recognized over time	248,405,822	228,511,401
CARES Act revenue	-	2,363,742
Lease income	9,496,755	6,791,929
Investment income, net	<u>204,017</u>	<u>449,109</u>
 Total revenue	 <u>\$ 398,880,859</u>	 <u>\$ 378,079,576</u>

11. PSP and Directed Payment Revenue

During 2021 and 2020, KMSF received \$86,051,793 and \$85,481,869, respectively, in PSP and directed payment revenue from the University of Kentucky. These funds are used to supplement KMSF's professional clinical service fees and to support the ongoing operations of KMSF.

12. Other Income

Other income consists of the following for the years ended June 30, 2021 and 2020:

	<u>2021</u>	<u>2020</u>
Medical and administrative services contractual income	\$ 21,929,524	\$ 19,672,032
EHR meaningful use	195,500	1,385,500
Prior years revenue adjustments	353,576	827,823
Shared savings payments	130,821	477,195
Royalty and honoraria income	133,948	134,345
Payor quality incentives	577,204	391,234
Other income	<u>484,185</u>	<u>559,091</u>
 Total other income	 <u>\$ 23,804,758</u>	 <u>\$ 23,447,220</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

13. Leasing Activities

KMSF leases office space to UK as well as other non-related entities. The lease contracts with UK vary with remaining terms ranging from one year to five years with optional extensions as provided by the various agreements. The lease contracts with the non-related entities vary with remaining terms ranging from less than one year to forty-eight years. KMSF received \$9,384,504 and \$6,660,046 in lease income from UK and \$112,251 and \$131,883 from other non-related entities in 2021 and 2020, respectively.

The following is a schedule of future minimum rentals under the noncancellable leases at June 30, 2021 for the next five years:

Year ending June 30,	
2022	\$ 8,389,897
2023	6,758,941
2024	3,964,790
2025	3,576,537
2026	3,576,537
Thereafter	<u>7,910,392</u>
	<u>\$ 34,177,094</u>

14. Medical Malpractice Insurance

KMSF is self-insured, along with UK, for malpractice claims. On an annual basis, the malpractice liability is actuarially determined at a consolidated basis using claims data from UK and KMSF. UK informs KMSF of their portion of the overall liability as well as their funding requirements to maintain appropriate funding levels. KMSF maintains their portion of the malpractice fund investments. Management believes the malpractice self-insurance fund is adequate to cover any losses.

15. Commitments and Contingencies

Litigation

KMSF is currently involved in litigation and/or regulatory investigations. KMSF's involvement typically arises either in the course of KMSF's business or in KMSF's role as a support organization for UK, and it is possible that the litigation and/or regulatory investigations could result in a material adverse effect on KMSF's future financial position or results from operations. Apart from matters where KMSF's involvement is part of such support role, management estimates these matters will be resolved without material adverse effect on KMSF's future financial position or results from operations.

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

15. Commitments and Contingencies, continued

Operating Leases

KMSF leases various equipment and facilities under operating leases that are set to expire at various dates. Total rental expense in 2021 and 2020 was \$1,786,340 and \$1,874,285, respectively.

The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2021:

Year ending June 30,	
2022	\$ 1,959,795
2023	708,140
2024	572,916
2025	501,235
2026	456,794
Thereafter	<u>365,971</u>
	<u>\$ 4,564,851</u>

16. Concentrations of Credit Risk

UK and KMSF grant credit without collateral to their patients, most of whom are area residents and are insured under third-party payor arrangements. The mix of receivables from patients and third-party payors at June 30, 2021 and 2020, was as follows:

	<u>2021</u>	<u>2020</u>
Medicaid	30 %	26 %
Other third-party payors	26	26
Medicare	19	22
Blue Cross	16	16
Patients	<u>9</u>	<u>10</u>
	<u>100 %</u>	<u>100 %</u>

KENTUCKY MEDICAL SERVICES FOUNDATION, INC.

Notes to the Financial Statements, continued

17. Healthcare Reform and Reimbursement Changes

The American Recovery and Reinvestment Act of 2009

On February 17, 2009, the *American Recovery and Reinvestment Act of 2009* (the Recovery Act) was signed into law. A major component of the Recovery Act is its emphasis on improving health information technology (also known as HIT). The federal government believes the implementation of technology will ultimately increase the quality and reduce the cost of healthcare.

To accomplish the improvement of HIT, the Recovery Act includes payment incentives for qualifying professionals. Physicians and hospitals that are considered early adopters of electronic health records (EHR) can become eligible to receive a significant amount of money from Medicare or Medicaid.

During the years ended June 30, 2021 and 2020, KMSF applied for and received \$195,500 and \$1,385,500 in Medicaid HIT funds, respectively. KMSF intends to apply for additional funds in the coming years. Both the 2021 and 2020 funds and any funds from past or future applications are contingent on reaching certain metrics and various states of "meaningful use" as defined by the Recovery Act.

Coronavirus Aid, Relief, and Economic Security (CARES) Act

In March 2020, the CARES Act was passed by legislation to assist businesses as a result of the economic impact caused by COVID-19. The CARES Act allocated aid to be provided to Medicare providers. During the years ended June 30, 2021 and 2020, KMSF received \$0 and \$2,363,742 in aid from the CARES Act, respectively.