

**The Fund for Advancement of
Education and Research in the
University of Kentucky Medical Center
A Component Unit of the University of Kentucky**

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors
The Fund for Advancement of
Education and Research in the
University of Kentucky Medical Center
Lexington, Kentucky

We have audited the accompanying basic financial statements of The Fund for Advancement of Education and Research in the University of Kentucky Medical Center (Fund), 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, 2010 and 2009, as listed in the table of contents. These financial statements are the responsibility of the Fund'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 audits 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 basic financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2010 and 2009, 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.

The accompanying management's discussion and analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the supplementary information and express no opinion on it.

BKD, LLP

September 30, 2010

Management's Discussion and Analysis

The Fund for Advancement of Education and Research in the University of Kentucky Medical Center's (The Fund) Management's Discussion and Analysis (MD&A) of its financial condition provides an overview of the financial performance of The Fund for the years ended June 30, 2010 and 2009. Management has prepared this discussion, which provides summary financial information, along with the financial statements and related footnotes. MD&A should be read in conjunction with the accompanying financial statements.

Financial Highlights

- Total assets decreased \$2.2 million or 14.7%, primarily due to decreases in cash and cash equivalents and accounts receivable.
- Total liabilities decreased \$331,000 or 21.9%, primarily due to a decrease in accounts payable.
- The decrease in total net assets of \$1.9 million, or 13.9%, was primarily in unrestricted net assets, due to operating expenses and grants to the University in excess of revenues.
- Operating revenues increased \$800,000 or 5.6% to \$15.0 million, largely due to increases in dental professional fees of \$814,000 or 8.5%.
- Operating expenses increased \$350,000 or 5.6% to \$6.6 million.
- Net assets represented 90.8% of total assets.

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 Fund's finances is whether The Fund is better off as a result of the year's activities. One key to answering this question is the financial statements of The Fund. The Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and the Statement of Cash Flows present financial information on The Fund in a format similar to that used by corporations, and present a long-term view of The Fund's finances. The Fund's net assets (the difference between assets and liabilities) are one sign of The Fund's financial health. Over time, increases or decreases in net assets indicate the improvement or erosion of The Fund's financial health, when considered in conjunction with non-financial facts.

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.

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 gifts and endowment and investment income to be classified as nonoperating revenues.

Another important factor to consider when evaluating financial viability is The Fund's ability to meet financial obligations as they become due. The Statement of Cash Flows presents information related to cash inflows and outflows, summarized by operating, capital, financing and investing activities.

Reporting Entity

The Fund is a not-for-profit Kentucky corporation established to promote, advance and support the educational, research, charitable and other purposes of the University of Kentucky Medical Center. The Fund is considered to be an affiliate and component unit of the University of Kentucky (the University) because all Board members are related to the University as faculty, staff or trustees and/or are appointed by the Board of Trustees of the University, and certain officers of The Fund are officers of the University.

Condensed Financial Information

Statements of Net Assets

	<u>2010</u>	<u>2009</u>	<u>2008</u>
ASSETS			
Current assets	\$ 12,903,317	\$ 15,160,347	\$ 16,209,161
Noncurrent assets	180,444	173,501	227,501
Total assets	<u>13,083,761</u>	<u>15,333,848</u>	<u>16,436,662</u>
LIABILITIES			
Current liabilities	1,180,038	1,510,915	1,307,931
Total liabilities	<u>1,180,038</u>	<u>1,510,915</u>	<u>1,307,931</u>
NET ASSETS			
Restricted			
Nonexpendable	30,642	30,642	30,642
Expendable	652,434	826,797	1,800,652
Unrestricted	11,220,647	12,965,494	13,297,437
Total net assets	<u>\$ 11,903,723</u>	<u>\$ 13,822,933</u>	<u>\$ 15,128,731</u>

Assets. As of June 30, 2010, The Fund's assets totaled \$13.1 million. Cash and cash equivalents, totaling \$10.7 million or 81.7% of total assets, represented The Fund's most significant asset. Accounts receivable (primarily for dental services), net of allowances, totaled \$2.2 million or 16.8% of total assets and was The Fund's second largest asset.

Total assets decreased \$2.2 million or 14.7% during the year ended June 30, 2010. This decrease was driven by decreases in cash and cash equivalents of \$1.5 million and in accounts receivable, net of allowances, of \$777,000.

Liabilities. At June 30, 2010, The Fund's liabilities totaled \$1.2 million. Amounts due to the University for faculty salary supplements of \$636,000 represent 53.9% of total liabilities. Accounts payable and accrued liabilities of \$453,000 and deferred revenue of \$91,000 comprised the remainder of The Fund's liabilities.

Total liabilities decreased \$331,000 or 21.9% during the year ended June 30, 2010. This decrease was primarily in accounts payable payments to vendors and patient refunds due to more timely payments.

Net Assets. Net assets at June 30, 2010, totaled \$11.9 million, or 90.8% of total assets. Restricted net assets totaled \$683,000 or 5.7% of total net assets and unrestricted net assets accounted for \$11.2 million or 94.3% of total net assets.

Total net assets decreased \$1.9 million or 13.9% during the year ended June 30, 2010 primarily as a result of a decrease in unrestricted net assets, due to operating expenses and grants to the University in excess of revenues.

2009 Versus 2008. During the year ended June 30, 2009:

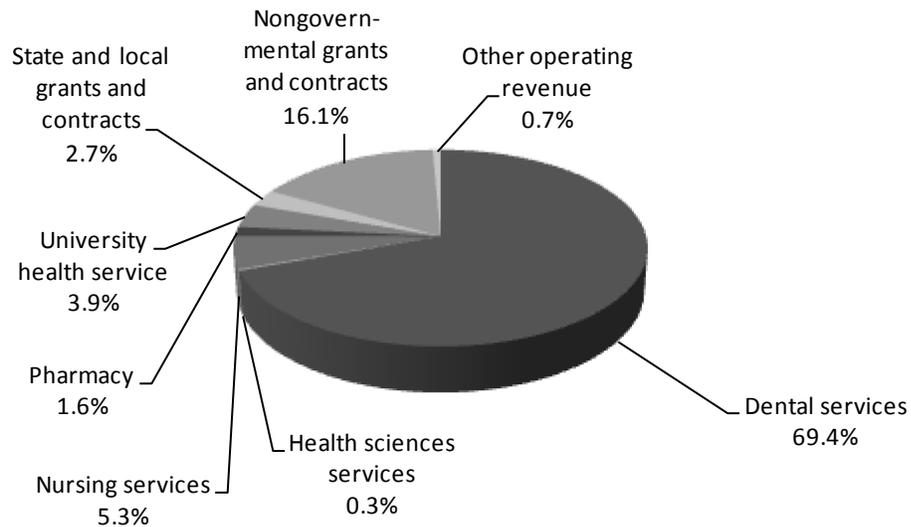
- Total assets decreased \$1.1 million or 6.7%. This decrease was driven by decreases in cash and cash equivalents and accounts receivable.
- Total liabilities increased \$203,000 or 15.5%, due primarily to an increase in accounts payable and accrued liabilities due to timing of payments to vendors.
- Total net assets decreased \$1.3 million or 8.6% primarily in restricted net assets due to operating expenses in excess of revenues.

Statements of Revenues, Expenses and Changes in Net Assets

	<u>2010</u>	<u>2009</u>	<u>2008</u>
OPERATING REVENUES			
Professional service fees, net of allowances			
Dental services	\$ 10,404,033	\$ 9,589,649	\$ 11,135,044
Health sciences services	45,495	37,138	42,104
Nursing services	790,178	904,085	718,083
Pharmacy	231,461	556,023	583,771
University health service	579,499	515,638	465,863
Total professional service fees	<u>12,050,666</u>	<u>11,602,533</u>	<u>12,944,865</u>
State and local grants and contracts	409,875	205,058	36,445
Nongovernmental grants and contracts	2,418,368	2,366,205	2,597,144
Other operating revenue	103,214	7,838	7,540
Total operating revenues	<u>14,982,123</u>	<u>14,181,634</u>	<u>15,585,994</u>
OPERATING EXPENSES			
Educational and general	<u>6,581,334</u>	<u>6,231,616</u>	<u>5,177,156</u>
Total operating expenses	<u>6,581,334</u>	<u>6,231,616</u>	<u>5,177,156</u>
NET INCOME FROM OPERATIONS	<u>8,400,789</u>	<u>7,950,018</u>	<u>10,408,838</u>
NONOPERATING REVENUES (EXPENSES)			
Gifts and grants	759,634	231,373	506,694
Investment income	44,897	70,678	465,996
Grants to the University of Kentucky	<u>(11,124,530)</u>	<u>(9,557,867)</u>	<u>(9,726,391)</u>
Total nonoperating revenues (expenses)	<u>(10,319,999)</u>	<u>(9,255,816)</u>	<u>(8,753,701)</u>
Total increase (decrease) in net assets	(1,919,210)	(1,305,798)	1,655,137
Net assets, beginning of year	<u>13,822,933</u>	<u>15,128,731</u>	<u>13,473,594</u>
Net assets, end of year	<u>\$ 11,903,723</u>	<u>\$ 13,822,933</u>	<u>\$ 15,128,731</u>

2010. Total operating revenues were \$15.0 million for the year ended June 30, 2010. The most significant source of operating revenues for The Fund was professional service fees, primarily dental, of \$12.1 million or 80.7% of the total. Operating revenues increased \$800,000 or 5.6%, due principally to an increase in dental professional service fees of \$814,000 resulting from an increase in patient services and the expansion of services in Western Kentucky.

TOTAL OPERATING REVENUES



Operating expenses totaled \$6.6 million. This entire amount was used for educational and general expenses related to functions such as academic support, instruction, research, institutional support and public services. Operating expenses increased \$350,000 or 5.6% primarily in dentistry due to the addition of dental services in Western Kentucky.

2009 Versus 2008. During the year ended June 30, 2009:

- Total operating revenues were \$14.2 million. The most significant source of operating revenues for The Fund was professional service fees, primarily dental service fees, of \$11.6 million or 81.7% of total operating revenues. Operating revenues decreased \$1.4 million or 9% due primarily to decreases in dental service fees of \$1.5 million resulting from a decline in patient services.
- Operating expenses totaled \$6.2 million. This entire amount was used for educational and general expenses related to functions such as academic support, instruction, hospitals and clinics, institutional support and public service. Operating expenses increased \$1.1 million or 20.4% due primarily to the payment by The Fund of dental clinics expense that were charged to the University in the prior year.

Statements of Cash Flows

Another way to assess the financial health of an organization is to look at the Statement of Cash Flows. The primary purpose of the Statement of Cash Flows is to provide information about the cash receipts and cash payments made by The Fund during the period. The Statement of Cash Flows also helps financial statement readers assess The Fund's:

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

	2010	2009	2008
CASH PROVIDED (USED) BY:			
Operating activities	\$ 8,949,239	\$ 8,560,866	\$ 10,017,269
Noncapital financing activities	(9,772,214)	(8,914,712)	(8,168,028)
Capital and related financing activities	(693,261)	(438,611)	(1,062,494)
Investing activities	36,691	121,836	495,613
	(1,479,545)	(670,621)	1,282,360
Cash and cash equivalents, beginning of year	12,144,537	12,815,158	11,532,798
Cash and cash equivalents, end of year	\$ 10,664,992	\$ 12,144,537	\$ 12,815,158

2010. The major source of funds included in operating activities was professional service fees of \$12.7 million. The largest cash payments for operating activities were made to suppliers of \$5.7 million.

Cash used in the noncapital financing activities group consisted of \$10.5 million in grants to the University of Kentucky offset by receipt of private gifts and grants of \$761,000.

Cash used by capital and related financing activities was related to grants of capital assets to the University.

Cash provided by investing activities included \$257,000 from the sale of investments and interest and dividend income of \$28,000, net of \$248,000 expended on the purchase of investments.

2009 Versus 2008. From June 30, 2008 to June 30, 2009 cash decreased \$671,000 primarily due to a decrease in cash provided by professional service fees.

Capital Asset and Debt Administration

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

Debt. The Fund had no debt at or during the year ended June 30, 2010.

Factors Impacting Future Periods

Dentistry's trend of increasing patient services is expected to continue in fiscal year 2011 due to continued outreach in Western Kentucky and increased number of patient visits in other locations. However, this anticipated growth in revenue could be adversely affected by a worsening of the economy. Dentistry projects a reduction in expenditures due to the completion of capital enhancement projects in the current fiscal year, with no similar capital enhancement projects planned for fiscal year 2011.

THE FUND FOR ADVANCEMENT OF EDUCATION AND RESEARCH
 IN THE UNIVERSITY OF KENTUCKY MEDICAL CENTER
 A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
 STATEMENTS OF NET ASSETS
 JUNE 30, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 10,664,992	\$ 12,144,537
Accounts receivable, net	2,238,325	3,015,810
Total current assets	<u>12,903,317</u>	<u>15,160,347</u>
Noncurrent Assets		
Endowment investments	179,005	170,798
Accounts receivable, net	1,439	2,703
Total noncurrent assets	<u>180,444</u>	<u>173,501</u>
Total assets	<u>13,083,761</u>	<u>15,333,848</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	453,245	773,066
Deferred revenue	90,828	-
Due to the University of Kentucky	635,965	737,849
Total current liabilities	<u>1,180,038</u>	<u>1,510,915</u>
Total liabilities	<u>1,180,038</u>	<u>1,510,915</u>
NET ASSETS		
Restricted		
Nonexpendable	30,642	30,642
Expendable	652,434	826,797
Total restricted	<u>683,076</u>	<u>857,439</u>
Unrestricted	<u>11,220,647</u>	<u>12,965,494</u>
Total net assets	<u>\$ 11,903,723</u>	<u>\$ 13,822,933</u>

See notes to financial statements.

**THE FUND FOR ADVANCEMENT OF EDUCATION AND RESEARCH
 IN THE UNIVERSITY OF KENTUCKY MEDICAL CENTER
 A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
 STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
 FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
OPERATING REVENUE		
Professional service fees, net of allowances:		
Dental services	\$ 10,404,033	\$ 9,589,649
Health sciences services	45,495	37,138
Nursing services	790,178	904,085
Pharmacy	231,461	556,023
University health service	<u>579,499</u>	<u>515,638</u>
Total professional service fees	12,050,666	11,602,533
State and local grants and contracts	409,875	205,058
Nongovernmental grants and contracts	2,418,368	2,366,205
Other operating revenues	<u>103,214</u>	<u>7,838</u>
Total operating revenues	<u>14,982,123</u>	<u>14,181,634</u>
OPERATING EXPENSES		
Educational and general:		
Instruction	501,337	574,203
Research	430,625	433,826
Public service	987,645	972,690
Libraries	3,489	3,498
Academic support	3,024,281	3,430,333
Student services	68,897	68,397
Institutional support	879,152	317,128
Student financial aid	611,993	322,682
Hospital and clinics	<u>73,915</u>	<u>108,859</u>
Total operating expenses	<u>6,581,334</u>	<u>6,231,616</u>
Net income gain from operations	<u>8,400,789</u>	<u>7,950,018</u>
NONOPERATING REVENUES (EXPENSES)		
Gifts and grants	759,634	231,373
Investment income	44,897	70,678
Grants to the University of Kentucky for non-capital purposes	<u>(10,431,269)</u>	<u>(9,119,256)</u>
Net nonoperating revenues (expenses)	<u>(9,626,738)</u>	<u>(8,817,205)</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>(1,225,949)</u>	<u>(867,187)</u>
Grants to the University of Kentucky for capital purposes	<u>(693,261)</u>	<u>(438,611)</u>
Total other revenues (expenses)	<u>(693,261)</u>	<u>(438,611)</u>
(decrease) in net assets	<u>(1,919,210)</u>	<u>(1,305,798)</u>
NET ASSETS, beginning of year	<u>13,822,933</u>	<u>15,128,731</u>
NET ASSETS, end of year	<u>\$ 11,903,723</u>	<u>\$ 13,822,933</u>

See notes to financial statements.

**THE FUND FOR ADVANCEMENT OF EDUCATION AND RESEARCH
 IN THE UNIVERSITY OF KENTUCKY MEDICAL CENTER
 A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
 STATEMENTS OF CASH FLOWS
 FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Professional service fees	\$ 12,743,522	\$ 12,089,820
Payments to vendors and contractors	(5,676,898)	(5,148,151)
Student financial aid	(611,993)	(322,682)
Salary, wage and benefit reimbursements to the University of Kentucky	(468,135)	(619,848)
Grants and contracts	2,859,529	2,553,889
Other receipts (payments)	103,214	7,838
Net cash provided (used) by operating activities	<u>8,949,239</u>	<u>8,560,866</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts and grants received for other than capital purposes	760,939	235,917
Grants (to) from the University of Kentucky	<u>(10,533,153)</u>	<u>(9,150,629)</u>
Net cash provided (used) by noncapital financing activities	<u>(9,772,214)</u>	<u>(8,914,712)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	<u>(693,261)</u>	<u>(438,611)</u>
Net cash provided (used) by capital and related financing activities	<u>(693,261)</u>	<u>(438,611)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	256,915	296,492
Interest and dividends on investments	27,880	121,836
Purchase of investments	<u>(248,104)</u>	<u>(296,492)</u>
Net cash provided (used) by investing activities	<u>36,691</u>	<u>121,836</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(1,479,545)</u>	<u>(670,621)</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>12,144,537</u>	<u>12,815,158</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 10,664,992</u>	<u>\$ 12,144,537</u>
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	\$ 8,400,789	\$ 7,950,018
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Change in assets and liabilities:		
Accounts receivable, net	777,443	376,491
Accounts payable and accrued liabilities	(319,821)	234,357
Deferred revenue	<u>90,828</u>	<u>-</u>
Net cash provided (used) by operating activities	<u>\$ 8,949,239</u>	<u>\$ 8,560,866</u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Fund for Advancement of Education and Research in the University of Kentucky Medical Center (The Fund) is a not-for-profit Kentucky corporation established to promote, advance and support the educational, research, charitable and other purposes of the University of Kentucky Medical Center (Medical Center). The Fund is considered to be an affiliate and component unit of the University of Kentucky (the University) because all Board members are related to the University as faculty, staff or trustees and/or are appointed by the Board of Trustees of the University, and certain officers of The Fund are officers of the University.

The Fund's mission is carried out through various means, including the operation of clinical practice plans and fundraising for several of the University's medical center programs.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net 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 Fund. Such assets include the principal of The Fund's permanent endowment funds.
 - Expendable* – Net assets whose use by The Fund is subject to externally imposed stipulations that can be fulfilled by actions of The Fund pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net assets whose use by The Fund 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 required by GASB Statement No. 35 is intended to provide a comprehensive, entity-wide perspective of The Fund's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

Pursuant to GASB Statement No. 20, The Fund has elected to apply the provisions for all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989 and do not conflict with or contradict GASB pronouncements.

Summary of Significant Accounting Policies

Accrual Basis. The financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. The Fund reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

Cash and Cash Equivalents. The Fund considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Accounts Receivable. This classification consists of patient accounts receivable, pledges and amounts due from affiliates that are verifiable, measurable and expected to be collected. Accounts receivable are recorded net of estimated uncollectible amounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Pooled Endowment Funds. The Fund'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 Management of Institutional Funds Act, as adopted by the Commonwealth of Kentucky, the University employs the total return method of investment management for setting investment objectives and determining investment performance. This method recognizes dividends and interest, plus or minus realized and unrealized gains or losses, in determining the total return earned during any particular period. Additionally, this method allows the University to appropriate for spending a prudent amount of realized and unrealized gains, in addition to traditional income. In July 2010, the Commonwealth of Kentucky will adopt the Uniform Prudent Management of Institutional Funds Act, which also allows the total return method of investment management.

For the years ended June 30, 2010 and 2009, the University's endowment spending rule provided for annual distributions of 4.5 percent of the thirty-six month moving average market value of fund units. For the years ended June 30, 2010 and 2009 approximately \$5,000 and \$4,500, respectively, was transferred from endowment realized and unrealized gains to support current programs in accordance with the University's endowment spending rule. Additionally, for the years ended June 30, 2010 and 2009, the University assessed eligible endowment accounts with a management fee of 0.5 percent of total asset value.

The Investment Committee of the University's Board of Trustees has approved a spending rate distribution of 4.375 percent and 4.25 percent of a sixty month moving average market value of fund units for the years ended June 30, 2011 and 2012, respectively. Additionally, the Investment Committee has approved a management fee of 0.375 percent and 0.25 percent of total asset value for the years ended June 30, 2011 and 2012, respectively.

Investments. Investments in marketable securities are carried at fair value, as determined by the major securities markets. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income in the Statement of Revenues, Expenses and Changes in Net Assets.

Deferred Revenue. Deferred revenue consists of amounts received from patients in advance of services rendered. Deferred revenue is recognized in the period in which services are rendered.

Professional Service Fees. Professional service fees are reported at net realizable amounts from patients, third-party payers and others for services rendered. Services covered by Medicare are reimbursed in accordance with the applicable published fee schedules from the Centers for Medicare and Medicaid Services while services rendered to Medicaid program beneficiaries are reimbursed according to a predetermined fee schedule provided by the Cabinet for Health and Family Services Department of Medicaid Services.

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

Nongovernmental Grants and Contracts. The University and Kentucky Medical Services Foundation, Inc. (KMSF) (an entity with which the University's faculty in its College of Medicine has "Practice Agreements and Assignments") have an agreement whereby The Fund receives two percent of clinical income collected

by KMSF to be used for academic enrichment of the College of Medicine. This revenue is classified as an operating activity in nongovernmental grants and contracts due to its contractual nature.

Grants to the University of Kentucky. Grants to the University are primarily for general program support and supplemental compensation of Medical Center health professionals. Other grants consist of capital assets purchased by The Fund that are granted to the University at the time of acquisition and endowment management fees.

Income Taxes. The Fund has been granted exemption from federal income taxation pursuant to the provisions of Internal Revenue Code section 501(c)(3).

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

Operating Activities. The Fund defines operating activities, as reported on the Statement of Revenues, Expenses and Changes in Net Assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for services and goods received. Nearly all of The Fund's revenues are from exchange transactions. Certain significant expenditures, such as grants to the University, are recorded as non-operating expenses, in accordance with GASB Statement No. 35.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to use estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The accompanying financial statements include estimates for items such as bad debt allowances.

2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Cash on deposit with the University of Kentucky	\$ 10,664,992	\$ 12,144,537
Investment in University of Kentucky pooled endowment fund	<u>179,005</u>	<u>170,798</u>
Total	<u>\$ 10,843,997</u>	<u>\$ 12,315,335</u>

At June 30, 2010, the University's pooled endowment fund consists of pooled equity funds (48.2%), pooled private equity funds (3.6%), pooled absolute return funds (10.0%), pooled real return funds (7.1%), pooled real estate funds (6.9%), U.S. Treasury fixed income (4.4%), government agency fixed income funds (2.0%), corporate fixed income funds (4.4%), pooled fixed income funds (12.1%) and cash equivalents (1.3%).

Deposit and investment policies. The Fund 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 Fund's balances.

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

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

Cash on deposit with the University is managed based on the University's Overnight and Short-Term Investment Policy approved by the Investment Committee of the University's Board of Trustees.

Endowment investments are managed by the University's Endowment Investment Policy as established by the Investment Committee of the University's Board of Trustees, which governs the University's pooled endowment fund.

Deposit and investment risks. The Fund's deposits and investments are exposed to various risks, including credit, interest rate and foreign currency risk, as discussed in more detail below:

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

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

- Cash on deposit with the University of Kentucky is governed by policy that minimizes risk in several ways. Deposits are governed by state law which requires full collateralization. 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 (the Commonwealth) is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth.
- Endowment managers are permitted to use derivative instruments to limit credit risk. 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 Fund will not be able to recover the value of its investment or collateral securities that are in possession of an outside party.

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

- Cash on deposit with the University is invested in deposits and repurchase agreements and are held in the University's name. Deposits and repurchase agreements with the Commonwealth of Kentucky are held in the Commonwealth's name. The University maintains records evidencing The Fund's ownership interest in such balances.
- Endowment investments are held in the University's name by the University's custodian. The University maintains records of The Fund's ownership interest (units) in the University's pooled endowment fund.

Concentrations of Credit Risk. The Fund's investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer. As a means of limiting its exposure to concentrations of credit risk, the University's investment policies limit concentrations in various investment types, as follows:

- Cash on deposit with the University is not limited as to the maximum amount that may be invested in one issuer. However, all such investments 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.
- The University's endowment fixed income managers are limited to a maximum investment in any one issuer of no more than five (5) percent of total investments excluding sovereign debt of governments belonging to the Organization for Economic Cooperation and Development and U.S. agencies.

At June 30, 2010, the Foundation had no underlying investments in any one issuer which represent more than five (5) percent of total investments other than U.S. treasury and agency obligations.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Cash on deposit with the University has limited exposure to interest rate risk due to the short term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Endowment managers are permitted to use derivative instrument 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 Barclay Aggregate Bond Index.

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

The Fund's exposure to foreign currency risk derives from certain endowment investments of the University's pooled endowment fund. The University's investment policy allows fixed income managers to invest a portion of their portfolios in non-U.S. securities. Additionally, the investment policy allows various pooled fund managers to invest in accordance with the guidelines established in each individual's fund's prospectus, which allows for investment in non-U.S. securities. 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.

The Fund invests in various securities. Investment securities are exposed to various interest rate, market and credit risks, discussed above. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the value of the investment securities will occur in the near term and that such change could affect the investment amounts in the Statement of Net Assets.

3. ACCOUNTS RECEIVABLE

Accounts receivable as of June 30, 2010 is as follows:

	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 2,506,579	\$ (733,449)	\$ 1,773,130
University health service patient accounts	214,684	-	214,684
Pledges receivable, discounted	2,881	-	2,881
Other receivables, primarily KMSF	249,069	-	249,069
Total	<u>\$ 2,973,213</u>	<u>\$ (733,449)</u>	<u>\$ 2,239,764</u>
Current portion			\$ 2,238,325
Noncurrent portion			1,439
Total			<u>\$ 2,239,764</u>

Accounts receivable as of June 30, 2009 is as follows:

	<u>Gross Receivable</u>	<u>Allowance</u>	<u>Net Receivable</u>
Dental patient accounts	\$ 3,716,187	\$ (1,176,517)	\$ 2,539,669
University health service patient accounts	158,498	-	158,498
Pledges receivable, discounted	4,187	-	4,187
Other receivables, primarily KMSF	316,159	-	316,159
Total	<u>\$ 4,195,031</u>	<u>\$ (1,176,517)</u>	<u>\$ 3,018,513</u>
Current portion			\$ 3,015,810
Noncurrent			2,703
Total			<u>\$ 3,018,513</u>

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Payable to vendors and contractors - operating	\$ 196,831	\$ 354,680
Credit balances on patient accounts	256,414	417,147
Due to the University of Kentucky accrued payroll	-	1,239
Total	<u>\$ 453,245</u>	<u>\$ 773,066</u>

5. DESIGNATIONS OF UNRESTRICTED NET ASSETS

The Fund's management and/or Board of Directors designates unrestricted net assets for specific purposes, as follows:

	<u>2010</u>	<u>2009</u>
Working capital needs	\$ 2,239,764	\$ 3,018,513
Budget appropriations for operating purposes for the upcoming fiscal year	3,399,200	2,992,900
Available for future operating purposes	5,581,683	6,954,081
Total	<u>\$ 11,220,647</u>	<u>\$ 12,965,494</u>

6. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Interest and dividends earned on endowment investments	\$ 4,175	\$ 5,454
Realized and unrealized gains and losses on endowment investments	17,017	(51,158)
Interest on cash and non-endowment investments	23,705	116,382
Total	<u>\$ 44,897</u>	<u>\$ 70,678</u>

7. PLEDGES AND DEFERRED GIFTS

Operating pledges totaling approximately \$4,077 are expected to be collected over the next three years. In accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, The Fund is required to record operating pledges as revenue when all eligibility requirements have been met. Accordingly, at June 30, 2010, The Fund recorded the discounted value of operating pledges receivable of approximately \$2,900.

8. RISK MANAGEMENT

The Fund is exposed to various risks of loss related to torts and errors and omissions. These risks are covered by extension of coverage by the University's participation in an insurance risk retention group and self-insurance. Claims against directors and officers for wrongful acts (errors and omissions) are insured through a risk retention group. There have been no significant reductions in insurance coverage from 2009 to 2010. Settlements have not exceeded insurance coverage during the past three years.

9. TRANSACTIONS WITH THE UNIVERSITY OF KENTUCKY

All salary, wage and benefit reimbursements to the University represent charges for University employees.

10. CURRENT ECONOMIC CONDITIONS

The current protracted economic decline continues to present not-for-profit organizations with difficult circumstances and challenges, which have lead to large declines in fair value of investments and donations. The rising unemployment rate has made it difficult for certain of The Fund's patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net revenues from professional service fees, which could have an adverse impact on The Fund's future operating results. The financial statements have been prepared using values and information currently available to The Fund.

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