

**UNIVERSITY OF LOUISVILLE
RESEARCH FOUNDATION, INC.**

A Component Unit of the University of Louisville

**Auditors' Report and Financial Statements
June 30, 2019 and 2018**

UNIVERSITY OF LOUISVILLE RESEARCH FOUNDATION, INC.

A Component Unit of the University of Louisville

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INDEPENDENT AUDITORS' REPORT

Board of Directors
University of Louisville Research Foundation, Inc.
Louisville, Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the University of Louisville Research Foundation, Inc. (Research Foundation), a component unit of the University of Louisville, as of and for the year ended June 30, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the Research Foundation's basic financial statements as listed in the table of contents.

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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 auditors' 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 opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Research Foundation as of June 30, 2019 and 2018, and the respective changes in financial position and, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 12, and the Schedule of Funding Progress on Page 31, be presented to supplement the basic financial statements. Such information, although not a 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.



CliftonLarsonAllen LLP

St. Louis, Missouri
October 3, 2019

UNIVERSITY OF LOUISVILLE RESEARCH FOUNDATION, INC.

A Component Unit of the University of Louisville

Management's Discussion and Analysis (Unaudited)

Introduction

The following discussion and analysis provides an overview of the financial position and activities of the University of Louisville Research Foundation, Inc. (Research Foundation) for the years ended June 30, 2019, 2018, and 2017. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The Research Foundation is a nonprofit corporation affiliated with the University of Louisville (University), a state-supported metropolitan research university located in Kentucky's largest city. The Research Foundation was established in 1989 for the purpose of promoting and supporting research projects, investigations, and other activities relating to the educational, scientific, literary, artistic, health care and public service missions of the University.

The University's strategic plan guides the Research Foundation's program. The Research Foundation accepts funding for research, training, and service from extramural sources and has maintained progress towards the goals established by the Kentucky Council on Postsecondary Education. During the fiscal year ended June 30, 2019, total awards were \$152.1 million, an increase of \$14.2 million or 10.3%, as compared to fiscal year 2018. Some of the funding highlights include:

- \$4.0 million from the Kentucky IDeA Networks of Biomedical Research Excellence;
- \$2.7 million from National Institutes of Health (NIH) for Protection of Ischemic Mocardium – Administrative Core;
- \$2.3 million from KY Counsel on Postsecondary Education Cancer Research Screening;
- \$2.2 million from the NIH for Griffithsin-based Rectal Microbicides for Prevention of Viral Entry.

Using the Financial Statements

The Research Foundation's financial report includes the Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows. These financial statements are prepared in accordance with Government Accounting Standards Board (GASB) principles. The Research Foundation is presented here as a single entity and is also included in the financial statements of the University.

GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis – for Public Colleges and Universities*, requires the Research Foundation to present a classified Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Position. Significant presentations under GASB Statement No. 35 with respect to the Research Foundation financial statements are as follows:

- Revenues and expenses are categorized as either operating or nonoperating. Certain revenues, including state appropriations, gifts, Pell and similar nonexchange grants, and investment income (loss) are considered nonoperating, as defined by GASB Statement No. 35. The Research Foundation's nonoperating revenues consist mainly of \$46.2 million and \$45.9 million in nonexchange grants and contract revenue for the years ended June 30, 2019 and 2018, respectively. These revenues relate to nonexchange transactions in which the Research Foundation is the beneficiary.

- Unexpended cash advances received for grants and sponsored programs are recorded as grant advances rather than as income when received. Such grant advance balances totaled \$11.3 million and \$9.6 million as of June 30, 2019 and 2018, respectively.
- Capital assets are depreciated and reported net of accumulated depreciation. The Research Foundation's capital assets as of June 30, 2019 and 2018 consist primarily of buildings, equipment and library materials with a net position value of \$56.4 million and \$57.7 million, respectively.

Financial Highlights

The Research Foundation's financial position remains stable at June 30, 2019, with total assets of \$122.9 million and liabilities of \$82.3 million as compared to June 30, 2018 at \$114.3 million of total assets and \$94.5 million of liabilities. Net position, which represents the residual interest in the Research Foundation's assets, deferred outflows of resources, liabilities and deferred inflows of resources, was \$29.8 million and \$18.3 million for the years ended June 30, 2019 and 2018, respectively.

Operating revenues amounted to \$415.7 million and \$380.5 million and operating expenditures were \$447.0 million and \$428.4 million resulting in a net operating loss of \$31.4 million and \$47.8 million for the years ended June 30, 2019 and 2018, respectively. When adjusted for net nonoperating revenues of \$42.8 million and \$32.7 million, net position of the Research Foundation increased by \$11.5 million and decreased by \$15.1 million for the years ended June 30, 2019, and 2018, respectively.

Statements of Net Position

The statements of net position present the financial position of the Research Foundation at the end of the fiscal year and include all assets, deferred outflows of resources, liabilities and deferred inflows of resources. Net position (the difference between assets, liabilities, deferred outflows of resources and deferred inflows of resources) provides a snapshot of the current financial condition of the Research Foundation at the end of a fiscal year. Items on the Statements of Net Position are generally measured using current values. The change in net position indicates whether the Research Foundation accumulated or consumed resources during the year. Capital assets are stated at historical cost less accumulated depreciation.

A condensed version of the Research Foundation's assets, liabilities, and net position at June 30, 2019, 2018, and 2017 is summarized on the following page:

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2019 - 2018</u> Change	<u>2018 - 2017</u> Change
ASSETS					
Current assets	\$ 61,758	\$ 50,209	\$ 37,763	\$ 11,549	\$ 12,446
Capital assets	56,423	57,680	61,726	(1,257)	(4,046)
Other noncurrent assets	4,758	6,443	6,374	(1,685)	69
Total assets	<u>122,939</u>	<u>114,332</u>	<u>105,863</u>	<u>8,607</u>	<u>8,469</u>
DEFERRED OUTFLOWS OF RESOURCES					
	1,049	1,240	-	(191)	1,240
LIABILITIES					
Current liabilities	58,290	62,211	40,527	(3,921)	21,684
Noncurrent liabilities	23,974	32,309	15,514	(8,335)	16,795
Total liabilities	<u>82,264</u>	<u>94,520</u>	<u>56,041</u>	<u>(12,256)</u>	<u>38,479</u>
DEFERRED INFLOWS OF RESOURCES					
	11,905	2,722	-	9,183	2,722
NET POSITION					
Net investment in capital assets	56,423	57,690	61,726	(1,267)	(4,036)
Restricted - expendable	25,583	27,500	24,465	(1,917)	3,035
Unrestricted	(52,187)	(66,860)	(36,369)	14,673	(30,491)
Total net position	<u>\$ 29,819</u>	<u>\$ 18,330</u>	<u>\$ 49,822</u>	<u>\$ 11,489</u>	<u>\$ (31,492)</u>

Assets

Current assets of \$61.8 million consist of \$45.2 million of accounts receivable that are to be collected within the next year. Current accounts receivable decreased by \$4.3 million, with a decrease of \$6.0 million in clinical activities and \$1.7 million increase in grant and contract activities. Due from affiliates increased from a receivable from an affiliate for \$15 million in 2019.

Noncurrent assets consist mainly of \$56.4 million of capital assets, which decreased due to \$6.1 million in depreciation offset by additional capital asset purchases of \$4.8 million.

Deferred Outflows of Resources

Deferred outflow of resources represents a consumption of net assets applicable to a future period. The balance of \$1.0 million as of June 30, 2019 consisted of future payments to be made for other post-employment benefits.

Liabilities

The Research Foundation's current liabilities consist of amounts due to the University of \$30.5 million for funding of operational expenses. This amount decreased \$9.5 million from the prior year. Additionally, current liabilities include \$11.3 million of unexpended cash advances for sponsored research activities, an increase of \$1.7 million compared to June 30, 2018. The Research Foundation is required to set up a liability when awards are paid in advance, as they are responsible for paying back any unused funds to the sponsor. The remaining \$16.5 million of current liabilities relates to trade accounts payable and other accrued liabilities. The Research Foundation's allocated portion of other post-employment benefits totals \$24.0 million, shown as other long-term liabilities which decreased by \$8.3 million due primarily to a change in actuarial assumptions.

Deferred Inflows of Resources

Deferred inflows of resources represent an acquisition of net position that applies to future periods. The balance of \$11.9 million is related to a change in actuarial assumptions and the difference between expected and actual experience used in the other postemployment benefit liability with the adoption of GASB 75.

Net Position

Net position represents the residual interest in the Research Foundation's assets after liabilities are deducted. The Research Foundation's net position at June 30, 2019 and 2018 was \$29.8 million and \$18.3 million, respectively. Net position is summarized into the three major categories in accordance with GASB Statement No. 35 and GASB Statement No. 63 reporting requirements as follows:

Net Investment in Capital Assets

The Research Foundation's net investments in capital assets represents construction in progress, buildings, equipment and depreciable library materials, net of accumulated depreciation. There is no debt attributable to the acquisition, construction or improvement of those assets. Capital assets decreased by \$1.3 million from 2018. This decrease reflects \$6.1 million of depreciation and addition of capital assets of \$4.8 million.

Restricted Expendable Net Position

Restricted expendable net position represents funds primarily from fixed payment contracts that are subject to externally imposed restrictions governing their use. Net position results from the excess of contract revenues over expenses incurred through June 30, 2019. The amounts remain restricted until the contract is completed.

Restricted expendable net position decreased \$1.9 million. The overall increase is due mainly to an increase in nongovernmental grants.

Unrestricted Net Position

Unrestricted net position increased by \$14.7 million. The increase in unrestricted net position results primarily from clinical services and fixed contract revenues exceeding actual operating expenses.

Fiscal Year 2018

The Research Foundation's financial position as of the fiscal year ended June 30, 2018 shows an increase in assets and liabilities with an overall decrease in net position. Assets increased during the fiscal year ended June 30, 2018 by \$8.5 million, or 8.0%, as compared to the fiscal year ended June 30, 2017. This increase was due mainly to the \$7.3 million increase in current accounts receivable. The increase in liabilities of \$38.5 million includes an increase of amounts due to the University of Louisville of \$18.1 million and an increase in other postemployment benefit liabilities of \$16.3 million.

Net position decreased \$31.5 million, or 63%, due mainly to the adoption of new accounting requirements for other post-retirement benefits in the restatement of unrestricted net position as of June 30, 2017 by a reduction of \$15.2 million and the decrease in net position for 2018.

Statements of Revenues, Expenses, and Changes in Net Position

The statements of revenues, expenses and changes in net position present the Research Foundation's results of operations. A condensed version of the Research Foundation's revenues, expenses and changes in net position for the years ended June 30, 2019, 2018, and 2017 is shown:

	2019	2018	2017	2019 - 2018 Change	2018 - 2017 Change
OPERATING REVENUES					
Clinical services	\$ 271,974	\$ 248,327	\$ 245,135	\$ 23,647	\$ 3,192
Grants and contracts	106,134	98,868	89,728	7,266	9,140
Facilities and administrative cost recoveries	28,248	27,035	25,064	1,213	1,971
Other operating revenues	9,327	6,303	3,214	3,024	3,089
Total operating revenues	<u>415,683</u>	<u>380,533</u>	<u>363,141</u>	<u>35,150</u>	<u>17,392</u>
OPERATING EXPENSES					
Depreciation	6,052	6,537	7,072	(485)	(535)
Other operating expenses	440,982	421,823	408,596	19,159	13,227
Total operating expenses	<u>447,034</u>	<u>428,360</u>	<u>415,668</u>	<u>18,674</u>	<u>12,692</u>
Operating loss	<u>(31,351)</u>	<u>(47,827)</u>	<u>(52,527)</u>	<u>16,476</u>	<u>4,700</u>
NONOPERATING REVENUES (EXPENSES)					
Nonexchange grants and contracts	46,179	45,881	44,629	298	1,252
Contributions to related entities	(4,153)	(13,765)	(2,491)	9,612	(11,274)
Other nonoperating revenues	814	565	(1,741)	249	2,306
Total nonoperating revenues	<u>42,840</u>	<u>32,681</u>	<u>40,397</u>	<u>10,159</u>	<u>(7,716)</u>
Decrease in net position	11,489	(15,146)	(12,130)	26,635	(3,016)
NET POSITION					
Net position, beginning of year	18,330	49,822	61,952	(31,492)	(12,130)
Cumulative effect of change in accounting principle	-	(16,346)	-	-	(16,346)
Net position, end of year	<u>\$ 29,819</u>	<u>\$ 18,330</u>	<u>\$ 49,822</u>	<u>\$ (4,857)</u>	<u>\$ (31,492)</u>

Operating Revenues

The Research Foundation recognized \$415.7 million in operating revenues for the year ended June 30, 2019. This represents an increase of \$35.2 million, or 9% in revenues from the \$380.5 million reported for the year ended June 30, 2018.

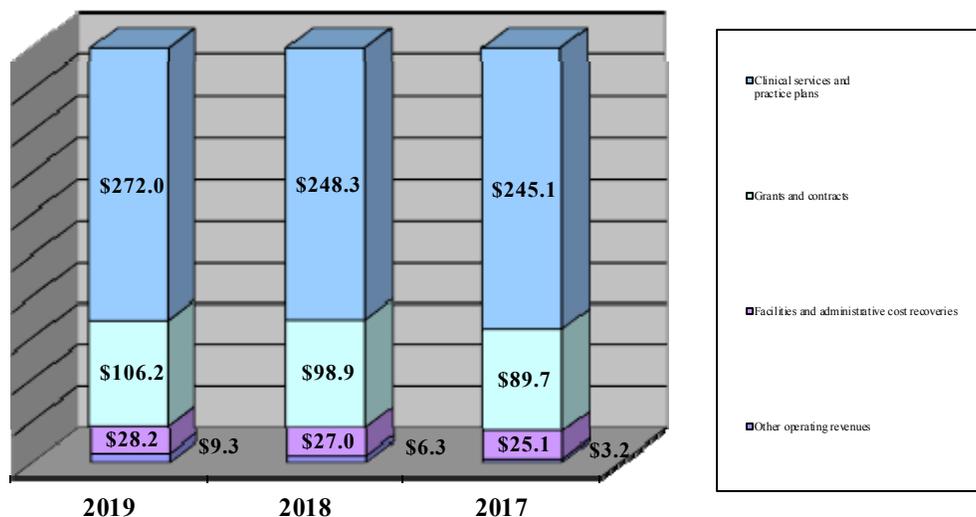
Revenues from clinical services were \$272.0 million for the year ended June 30, 2019. This is an increase of approximately \$23.6 million, or 10%, compared to \$248.3 million in similar revenues reported for the year ended June 30, 2018. The majority of the increase is attributed to academic program support of \$10.0 million received from an affiliate and \$15.1 million received from an affiliate for mission support (further described in Note 7 to the financial statements.)

Revenues from grants and contracts were \$106.1 million for the year ended June 30, 2019 as compared to \$98.9 million in revenues reported in the previous year. This includes an increase of \$7.0 million in federal grants and contracts and an increase of \$3.2 million in state and local grants and contracts.

Revenue from facilities and administrative cost recoveries were \$28.2 million and \$27.0 million for the years ended June 30, 2019 and 2018, respectively. The Research Foundation compensates the University for a portion of the cost recoveries in support of University expenditures. For the years ended June 30, 2019 and 2018, approximately \$10.2 million and \$11.8 million, respectively, were transferred to the university for this purpose.

The following is a graphic illustration of the Research Foundation’s operating revenues by major source for the years ended June 30, 2019, 2018, and 2017 (in millions).

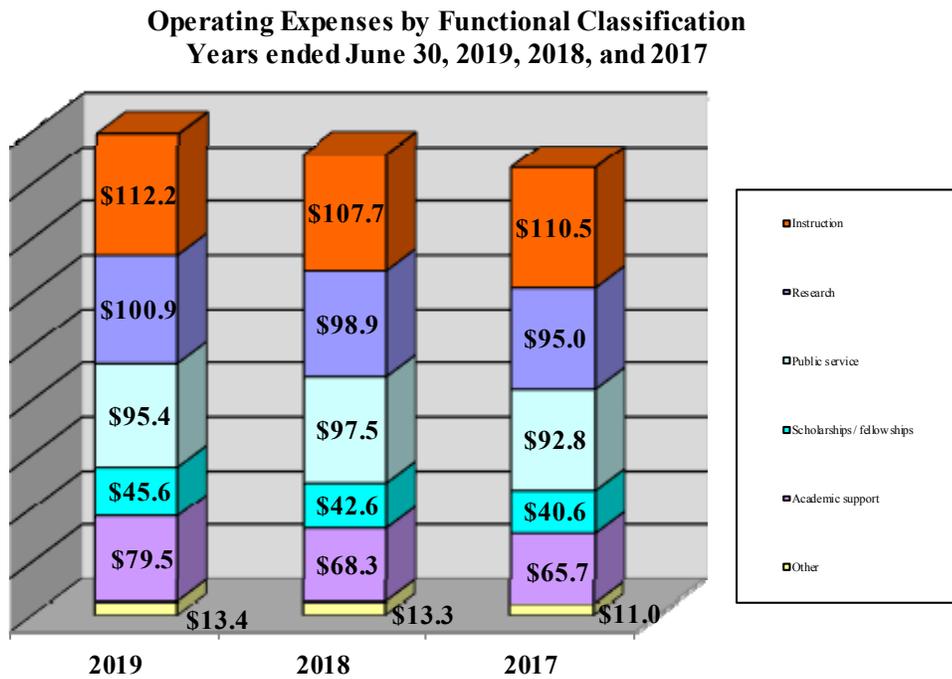
Operating Revenues Years Ended June 30, 2019, 2018, and 2017



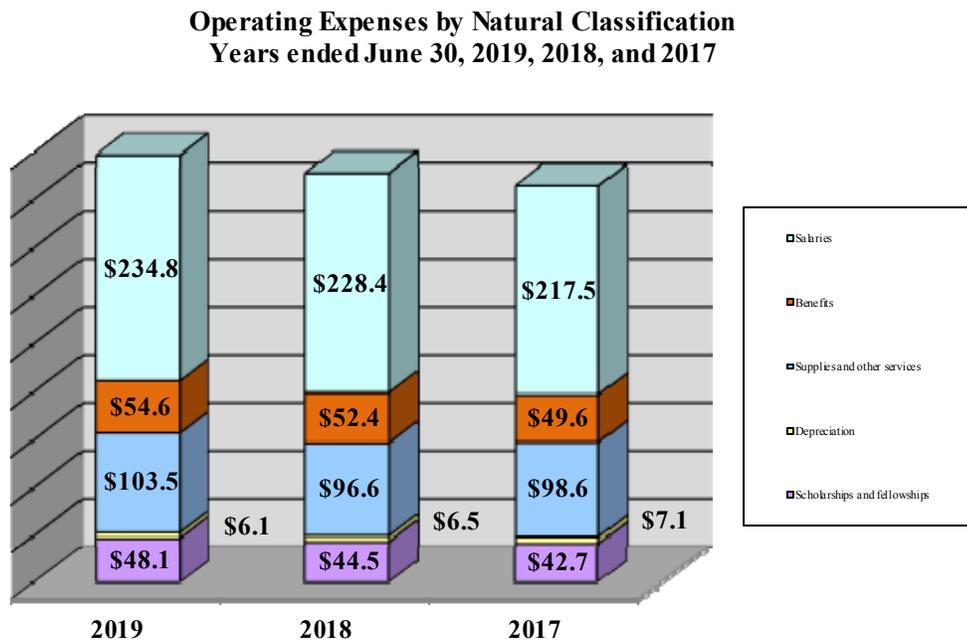
Operating Expenses by Functional and Natural Class

Total operating expenses were \$447.0 million and \$428.4 million for the fiscal years ended June 30, 2019 and 2018, respectively. The primary drivers of the increase of \$18.7 million, or 4.0%, is an increase of \$6.4 million in salary expense and an increase of \$3.6 million in scholarships and fellowships as shown in the operating expenses by natural classification chart on the following page. Expenses in functional classification for instruction, research and scholarship and fellowships all increased due to these increases along with increases in general supplies and services.

The following is a graphic illustration of total operating expenses by function for the years ended June 30, 2019, 2018 and 2017 (in millions):



The following is a graphic illustration of total operating expenses by natural classification for the years ended June 30, 2019, 2018 and 2017 (in millions):



Nonoperating Revenues (Expenses)

The Research Foundation's total nonoperating revenues of \$42.8 million for fiscal year ended June 30, 2019, was mostly comprised of nonexchange grants and contract revenues of \$46.2 million reduced by transfers to the university of \$4.2 million for support of university operations. Total nonoperating revenues increased by \$10.2 million as compared to fiscal year ended June 30, 2018. The increase is attributed to an increase in nonexchange grants and contract revenues of \$0.3 million, an increase of \$0.3 million in gifts and a decrease in support provided to the university of \$9.6 million. The increase was offset by a small decrease in other nonoperating income in fiscal year ending June 30, 2019.

Fiscal Year 2018

For the year ended June 30, 2018, Research Foundation reported \$380.5 million in operating revenues, an increase of \$16.5 million, or 5% compared to the \$363.1 million reported for the year ended June 30, 2017.

Revenues from clinical services were \$248.3 million for fiscal year 2018, an increase of \$3.1 million or 1% from the fiscal year ended June 30, 2017. The majority of the increase is attributed to increases in Medicaid related patient and intergovernmental transfers.

Revenues from grants and contracts were \$98.9 million for the year ended June 30, 2018 as compared to \$89.7 million in revenues reported in the previous year. This includes an increase of \$5.0 million in nongovernmental grants and contracts and an increase of \$4.1 million in federal grants and contracts.

Revenue from facilities and administrative cost recoveries were \$27.0 million and \$25.1 million for the years ended June 30, 2018 and 2017, respectively. The Research Foundation transferred approximately \$11.8 million and \$10.9 million during the years ended June 30, 2018 and 2017, respectively, in recognition of indirect support provided by the University.

Total operating expenses were \$428.4 million and \$415.7 million for the fiscal years ended June 30, 2018 and 2017, respectively. The increase of \$12.7 million, or 3%, was mainly due to an increase of \$10.7 million in salary expenses.

Statements of Cash Flows

The statements of cash flows provide information about the Research Foundation's cash position by reporting the sources and uses of cash during the year. Cash inflows and outflows are categorized as operating, noncapital financing, capital financing and investing activities.

Condensed statements of the Research Foundation's cash flows for the years ended June 30, 2019, 2018, and 2017, are summarized on the following page:

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2019 - 2018</u> <u>Change</u>	<u>2018 - 2017</u> <u>Change</u>
Cash (used)/provided by:					
Operating activities	\$ (14,442)	\$ (48,940)	\$ (26,890)	\$ 34,498	\$ (22,050)
Noncapital and related financing activities	19,237	51,435	29,710	(32,198)	21,725
Capital financing activities	(4,795)	(2,534)	(2,877)	(2,261)	343
Investing activities	-	39	57	(39)	(18)
Net decrease in cash	-	-	-	-	-
Cash and cash equivalents, beginning of year	-	-	-	-	-
Cash and cash equivalents, end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Operating Activities

The Research Foundation's operating activities used approximately \$14.4 million of cash during the fiscal year ended June 30, 2019, representing a decrease of \$34.5 million compared to the prior year. The most significant driver in the reduction of cash usage is the additional support payments totaling \$25 million during the fiscal year ended June 30, 2019.

Other Activities

The \$19.2 million cash provided by noncapital and related financing activities relates mainly to the \$46.2 million provided by nonexchange grants and contracts. It also includes the Research Foundation's support from the University of \$23.6 million for operating revenue shortfalls. In total, cash provided by noncapital and related financing activities decreased \$32.2 million from the fiscal year ended June 30, 2018.

Cash used for capital financing activities increased \$2.3 million to \$4.8 million during the fiscal year ended June 30, 2019.

Fiscal Year 2018

The Research Foundation operating activities used approximately \$48.9 million of cash during the fiscal year ended June 30, 2018, representing an increase of \$22.1 million compared to the cash used for operations in the prior year. The most significant increases were in cash outflows for salaries and benefits of \$29.5 million offset by an increase in clinical services of \$7.6 million from operations during the fiscal year ended June 30, 2017.

The \$51.5 million cash provided by noncapital and related financing activities relates mainly to the \$46.3 million provided by nonexchange grants and contracts. It also includes the Research Foundation's transfer of \$14.3 million to the University as reimbursement for indirect charges to support the use of buildings and labs and support from the University of \$18.3 million for operating revenue shortfalls. In total, cash provided by noncapital and related financing activities increased \$21.7 million from the fiscal year ended June 30, 2017.

Economic Factors that May Affect the Future

The University is committed to achieving preeminence as a nationally recognized metropolitan research university and as an institution recognized for excellence in education, as well as pioneering in research and scholarly activity. Senior leadership continues to believe the University is financially well-positioned to educate and serve its community through:

- Teaching diverse undergraduate, graduate, and professional students in order to develop engaged citizens, leaders, and scholars,
- Practicing and applying research, scholarship and creative activity, and
- Providing engaged service and outreach that improve the quality of life for local and global communities.

The following is a brief discussion of economic and other factors that could have an impact on the University in the future:

- Kentucky implemented a performance-funding model in 2017 whereby institutions are incentivized to improve student outcomes based on priorities (metrics) identified by the state. Performance-based funding adds an element of budgetary uncertainty that will impact state funding for the university. In 2020 and beyond, a portion of each university's state appropriation will depend upon how it performs on several student and operational metrics relative to other universities.
- The projected high school graduate population in the near- and medium-term future is strong through 2026. Institutions focused on first-time, full-time baccalaureate degree-seeking students will be gearing up and recruiting hard during the three year period 2024 to 2026 when graduation rates are expected to peak. However, between years 2027 and 2032, the average graduating class size is expected to decline to levels similar to 2013 which will heighten competition and constrain tuition revenue.
- Improved operations of pediatric clinical activities is expected through a partnership with Norton Healthcare, Inc. (Norton), where Norton will take over the management of these operations. The expected result of the partnership is streamlined operations and support functions resulting in better margins.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the University's finances and to show the University's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Controller, University of Louisville, Louisville, KY 40292.

University of Louisville Research Foundation, Inc.
A Component Unit of the University of Louisville
Statements of Net Position
As of June 30, 2019 and 2018
(In Thousands)

	2019	2018
ASSETS		
Current Assets:		
Accounts receivable, net	\$ 45,243	\$ 49,514
Due from Affiliate	15,797	65
Inventories	412	412
Other assets	306	218
Total current assets	61,758	50,209
Noncurrent Assets:		
Accounts receivable, net	715	811
Other long-term assets	-	2
Due from Affiliate	4,043	5,630
Capital assets, net	56,423	57,680
Total noncurrent assets	61,181	64,123
Total assets	122,939	114,332
DEFERRED OUTFLOWS OF RESOURCES	1,049	1,240
LIABILITIES		
Current Liabilities:		
Accounts payable and accrued liabilities	16,509	12,620
Due to University of Louisville	30,528	39,988
Grant advances	11,253	9,603
Total current liabilities	58,290	62,211
Noncurrent Liabilities:		
Other long-term liabilities	23,974	32,309
Total noncurrent liabilities	23,974	32,309
Total liabilities	82,264	94,520
DEFERRED INFLOWS OF RESOURCES	11,905	2,722
NET POSITION		
Net investment in capital assets	56,423	57,690
Restricted - expendable for:		
Research	20,261	19,873
Instruction	122	634
Public service	3,097	2,897
Scholarships and fellowships	-	278
Academic support	6	6
Institutional Support	2,025	3,740
Operation and Maintenance	72	72
Unrestricted	(52,187)	(66,860)
Total net position	\$ 29,819	\$ 18,330

See notes to the financial statements

University of Louisville Research Foundation, Inc.
A Component Unit of the University of Louisville
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2019 and 2018
(In Thousands)

	<u>2019</u>	<u>2018</u>
OPERATING REVENUES		
Clinical services, net of contractual allowances of \$106,293 in 2019 and \$96,364 in 2018	\$ 271,974	\$ 248,327
Federal grants and contracts	79,485	72,461
State and local grants and contracts	11,368	8,191
Nongovernmental grants and contracts	15,281	18,216
Other operating revenue	9,327	6,303
Facilities and administrative cost recoveries	28,248	27,035
Total operating revenues	<u>415,683</u>	<u>380,533</u>
OPERATING EXPENSES		
Instruction	112,227	107,698
Research	100,905	98,939
Public service	95,435	97,483
Scholarships and fellowships	45,558	42,592
Academic support	79,472	68,292
Institutional support	7,504	7,040
Operation and maintenance of plant	(133)	(284)
Depreciation	6,052	6,537
Student services	7	64
Service centers	7	(1)
Total operating expenses	<u>447,034</u>	<u>428,360</u>
Operating loss	<u>(31,351)</u>	<u>(47,827)</u>
NONOPERATING REVENUES (EXPENSES)		
Gifts	775	480
Nonexchange grants and contracts	46,179	45,881
Net realized and unrealized gain on investments	-	39
Other nonoperating income	39	46
Net nonoperating revenues	<u>46,993</u>	<u>46,446</u>
Contributions to related entities	<u>(4,153)</u>	<u>(13,765)</u>
Total other revenues	<u>42,840</u>	<u>32,681</u>
Increase/(Decrease) in net position	11,489	(15,146)
NET POSITION		
Net position - beginning of year	18,330	49,822
Cumulative effect of change in accounting principle	-	(16,346)
Net position - end of year	<u>\$ 29,819</u>	<u>\$ 18,330</u>

See notes to the financial statements

University of Louisville Research Foundation, Inc.
A Component Unit of the University of Louisville
Statements of Cash Flows
For the Years Ended June 30, 2019 and 2018
(In Thousands)

	<u>2019</u>	<u>2018</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Clinical services	\$ 279,579	\$ 248,368
Grants and contracts	112,783	100,308
Facilities and administrative cost recoveries	28,248	27,035
Other operating revenue	9,327	6,224
Payments to employees	(247,756)	(236,302)
Payments for benefits	(48,322)	(50,267)
Payments for scholarships and fellowships	(48,138)	(44,493)
Payments to suppliers	(100,163)	(99,813)
Net cash used by operating activities	<u>(14,442)</u>	<u>(48,940)</u>
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES		
Contributions to/from related entities	(4,153)	(14,261)
Gifts	775	480
Nonexchange grants and contracts	46,179	46,349
Due to (due from) University of Louisville	(23,603)	18,315
Other noncapital financing activity	39	552
Net cash provided by noncapital and related financing activities	<u>19,237</u>	<u>51,435</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchases of capital assets	(4,795)	(2,534)
Net cash used by capital and related financing activities	<u>(4,795)</u>	<u>(2,534)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Sales of investments	-	39
Net cash provided by investing activities	<u>-</u>	<u>39</u>
Net decrease in cash and cash equivalents	-	-
Cash and cash equivalents - beginning of year	-	-
Cash and cash equivalents - end of year	<u>\$ -</u>	<u>\$ -</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating loss	\$ (31,351)	\$ (47,827)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation	6,052	6,537
Loss on disposal of equipment	-	44
Changes in assets and liabilities:		
Accounts receivable, net	4,367	(7,883)
Inventories	-	42
Other assets	(89)	65
Accounts payable and accrued liabilities	3,890	(3,434)
Grant advances	1,650	1,546
Other long-term liabilities	(8,335)	488
Deferred outflows	191	(1,240)
Deferred inflows	9,183	2,722
Net cash used by operating activities	<u>\$ (14,442)</u>	<u>\$ (48,940)</u>

See notes to the financial statements

University of Louisville Research Foundation, Inc.

A Component Unit of the University of Louisville

Notes to Financial Statements

June 30, 2019 and 2018

1. Organizations and Summary of Significant Accounting Policies

The University of Louisville Research Foundation, Inc. (the Research Foundation) is affiliated with the University of Louisville (the University) through common management and substantially the same Board of Directors. The Research Foundation is consolidated into the University's financial statements. The Research Foundation is a separate corporation organized for the purpose of conducting the research, clinical operations, and other sponsored activities of the University. The significant accounting policies followed by the Research Foundation are described below.

a. 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 Government Accounting Standards Board (GASB).

The financial statements of the University have been prepared on the accrual basis of accounting. Revenues, expenses, gains, losses, assets, liabilities and deferred inflows and outflows of resources from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally federal and state grants and state appropriations) are recognized when all applicable eligibility requirements are met. Internal activity and balances are eliminated in preparation of the financial statements unless they relate to services provided and used internally. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific, investment income and interest on capital asset-related debt are included in nonoperating revenues and expenses. The University first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

The financial statements of the Research Foundation can be found online at the following:
<http://louisville.edu/finance/controller/univacct/finst-1>

b. Cash and Cash Equivalents

The Research Foundation considers all investments with an original maturity of three months or less to be cash equivalents.

c. Accounts Receivable

Accounts receivable consists of clinical and sponsored agreement charges. Clinical receivables are comprised of patient and insurance charges. Healthcare entities are charged for contracted staff support services. Sponsored agreement receivables relate to sponsored programs that support the Research Foundation. Accounts receivable are recorded net of estimated uncollectible amounts.

d. Inventories

Inventories are stated at the lower of cost or market on a first-in, first-out (FIFO) basis.

e. Capital Assets

Equipment and library books of the Research Foundation are stated at cost or, in the case of donated capital assets, estimated acquisition value at date of receipt from donors.

Movable equipment costing \$5,000 and greater and having a useful life greater than one year are capitalized. Renovations to buildings, infrastructure and land improvements, if any, that significantly increase the value or extend the useful life of the structure and are in excess of \$100,000 are capitalized. Necessary and routine repairs and maintenance are charged to operating expense in the year the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets as follows: buildings - 40 years or componentized using 15-50 years, library books - 10 years, and equipment - 3 to 20 years. The Research Foundation capitalizes, but does not depreciate, works of art and rare books.

Prior to July 1, 2002 it was the policy of the University to record all capital assets purchased by the Research Foundation as property of the University.

f. Deferred Inflows and Outflows of Resources and Net Position

In accordance with GASB No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, the Foundation reports deferred outflows of resources, deferred inflows of resources and net position in its statement of net position and related disclosures. Deferred outflows of resources of \$1.0 million for the year ended June 30, 2019, consist of future payments to be made for other post-employment benefits. Deferred inflows of resources of \$11.9 million as of June 30, 2019 consist of changes in the other post-employment benefits liability and will be amortized into expenses in future periods.

g. Classification of Revenues

The Research Foundation has classified its revenues as either operating or nonoperating revenues according to the following criteria:

Operating revenues include activities that have the characteristics of exchange transactions, such as (1) clinical services, (2) grants and contracts, and (3) facilities and administrative cost recoveries.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as Pell and other grants and contracts, gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Government Entities That Use Proprietary Fund Accounting*, and GASB No. 34, *Basic Financial Statements-And Management's Discussion and Analysis-For State and Local Governments*.

h. Net Clinical Services Revenue

The Research Foundation has agreements with third-party payers that provide for payments to the Research Foundation at amounts different from its established rates. Net clinical services revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for the services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

i. Grant Advances

The Research Foundation receives revenues relative to sponsored agreements via grants, contracts, or cooperative agreements. The flow of funds relative to these sponsored agreements is in the form of cost reimbursement or advanced funding.

In the case of cost reimbursement, the Research Foundation incurs costs on behalf of the granting authority and is then reimbursed for such costs pursuant to the terms of the sponsored agreement. Grant revenues are recognized as reimbursable costs are incurred.

In the case of advanced funding, the Research Foundation receives funds prior to incurring costs pursuant to the sponsored agreement, with the stipulation that these funds may have to be returned to the sponsor in the event the project is not completed to the sponsor's satisfaction. These funds, totaling approximately \$11.3 million and \$9.6 million as of June 30, 2019 and 2018, respectively, are recorded as a liability in the Research Foundation's financial statements as grant advances and recognized as revenue as reimbursable cost are incurred.

j. Compensated Absences

Research Foundation policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment.

Expense and the related liability are recognized as the vacation or sick benefits are earned, whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the statement of net position date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

k. Net Position

The net position of the Research Foundation is classified in three components. Net investment in capital assets consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net position consists of noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Research Foundation.

Unrestricted net position consists of the remaining assets less remaining liabilities that do not meet the definition of net investment in capital assets or restricted net position.

l. Government Grants

Support funded by grants is recognized as the Research Foundation performs the contracted services or incurs outlays eligible for reimbursement under the grant agreements. Grant activities and outlays are subject to audit and acceptance by the granting agency and, as a result of such audit, adjustments could be made.

m. Tax Status

As an affiliate of a state institution of higher education, the income of the Research Foundation is generally exempt from federal and state income taxes under Section 115(a) of the Internal Revenue Code and a similar provision of state law. However, the Research Foundation is subject to federal income tax on any unrelated business income.

n. Use of Estimates

The preparation of the financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

o. Reclassifications

Certain 2018 amounts have been reclassified to conform to the 2019 presentation. The reclassifications more accurately represent revenue and expense activities in the categories presented on the statement of revenues, expense and changes in net position. These reclassifications had no effect on the change in net position.

p. Recent Accounting Pronouncements and Restatement

As of June 30, 2019, the following GASB statements were implemented which had a financial or disclosure impact on the financial statements.

GASB Statement No. 83, *Certain Asset Retirement Obligations*. The statement requires identification and assessment of cost of legally enforceable activities associated with the retirement of tangible capital assets. The university identified potential tangible assets that would qualify and assessed the liability using quoted prices and industry standards. The estimated cost was deemed to have no material impact to the university.

GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. The updated disclosures did not have a material impact to the university.

As of June 30, 2019, the GASB has issued the following statements that could be applicable to the University upon implementation in future reporting periods.

GASB Statement No. 84, *Fiduciary Activities*. This statement improves guidance regarding the identification of fiduciary activities for accounting and financial reporting.

GASB Statement No. 90, *Majority Equity Interest – an amendment of GASB Statements No. 14 and No. 61*. This statement will improve financial reporting by providing users of the financial statements with essential information related to the presentation of majority equity interests in legally separate organizations that previously was reported inconsistently. In addition, requiring reporting of information about component units if the government acquires a 100 percent equity interest provides information about the cost of services to be provided by the component unit in relation to the consideration provided to acquire the component unit.

GASB Statement No. 87, *Leases*. Requires recognition of certain lease assets and liabilities for leases that were previously classified as operating, and establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use. The University has not yet adopted this standard and is evaluating the impact it may have on its financial statements.

During the year ended June 30, 2018 the University implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The implementation of this standard resulted in restating beginning net position as of July 1, 2017.

2. Cash and Cash Equivalents

The Research Foundation maintains various deposits. Custodial credit risk for deposits is the risk that in the event of a bank failure, the Research Foundation's deposits or collateral securities may not be returned to it. For administrative convenience, cash balances of the Research Foundation are included in bank accounts maintained by the University. Details of accounting transactions affecting cash are maintained in such a manner as to ensure an appropriate segregation of amounts maintained by each entity.

The University currently uses commercial banks and the Commonwealth of Kentucky (the Commonwealth) as its depositories. Deposits with commercial banks are covered up to the limits federal depository insurance or collateral held by the bank in the University's name. At the Commonwealth, the University's accounts are pooled with other agencies of the Commonwealth. These Commonwealth-pooled deposits are substantially covered by federal depository insurance or by collateral held by the Commonwealth in the Commonwealth's name. The Research Foundation does not have a formal policy addressing custodial credit risk.

3. Transactions with Related Entities

a. Contributions with Related Entities

The University provides certain facilities and administrative services to the Research Foundation for a share of the facilities and administrative cost recoveries. The current agreement provides for a transfer of 80%, after certain deductions, of the amount realized. Transfers from the Research Foundation to the University for their portion of cost recoveries totaled \$10.2 million and \$11.8 million for the years ended June 30, 2019 and 2018, respectively.

Research and operational support provided by University totaled \$7.3 million for the year ending June 30, 2019. The Research Foundation provided \$2.8 million of support to the University for the year ending June 30, 2018.

The Research Foundation transferred \$3.3 million and \$1.9 million related to capital projects and debt service payments during the years ended June 30, 2019 and 2018, respectively, to the University. These transfers relate to certain capital projects, which are financed by the University, and as such, are recorded as assets of the University.

For each of the years ended June 30, 2019 and 2018, the Research Foundation was the recipient of \$2.0 million and \$2.1 million, respectively, from related entities to assist in funding cost share required by certain sponsored programs and grants.

b. Receivables With Related Entities

The Research Foundation received a \$5.9 million unsecured, noninterest bearing note from University of Louisville Physicians, Inc., an affiliate entity, for past due fees owed the Research Foundation. The outstanding note balance is \$4.8 million as of June 2019.

c. Guarantees

A memorandum of understanding dated April 2017 between the Research Foundation and ULP establishes obligations of the Research Foundation in the event ULP does not meet certain requirements under a lease agreement with PMOB, Inc. PMOB, Inc. has a \$48.6 million loan with a financial institution to construct a medical office building. ULP entered into a lease with PMOB, Inc. for a majority of the space within the medical office building and to provide \$9.5 million of furniture, fixtures and equipment for the leased space. For as long as the loan agreement between PMOB, Inc. and the financial institution remains in effect, the Research Foundation has provided assurance through a guarantee that all of ULP's obligations due to PMOB, Inc. under the lease and any unfunded portion of the leased premise furniture, fixture and equipment will be paid. The Research Foundation's obligation shall not exceed funds received by the Research Foundation for services provided by ULP for clinical services as of the date of the memorandum of understanding.

A memorandum of understanding dated March 2017 between the Research Foundation and ULP establishes the obligation for the Research Foundation to make annual lump sum payments through July 2020 to a lending institution holding debt of ULP for the servicing of ULP scheduled debt payments. The payments made by the Research Foundation are for services rendered by ULP.

d. Sale of Passport Health Plan

On May 10, 2019 Evolent Health Inc. (Evolent) and ULP, Norton Healthcare, Inc., UMC, Jewish Heritage Fund for Excellence, Inc. and Louisville Primary Care Association reached an agreement whereby Evolent would buy a 70% stake in Passport Health Plan for \$70 million. The transaction is expected to close in early fiscal 2020. The University owned a 2% stake in Passport as of the date of the agreement.

4. Accounts Receivable, Net

Accounts receivable, net as of June 30, 2019 and 2018, are summarized as follows (in thousands):

	2019		
	Gross Receivable	Allowance	Net Receivable
Patient care	\$ 56,221	\$ (36,621)	\$ 19,600
Sponsored agreements	28,121	(1,763)	26,358
Total	<u>\$ 84,342</u>	<u>\$ (38,384)</u>	45,958
Current portion			<u>45,243</u>
Noncurrent portion			<u>\$ 715</u>
	2018		
	Gross Receivable	Allowance	Net Receivable
Patient care	\$ 67,381	\$ (41,729)	\$ 25,652
Sponsored agreements	26,436	(1,763)	24,673
Total	<u>\$ 93,817</u>	<u>\$ (43,492)</u>	50,325
Current portion			<u>49,514</u>
Noncurrent portion			<u>\$ 811</u>

5. Capital Assets, Net

Capital assets at historical cost as of June 30, 2019 and 2018 are summarized as follows (in thousands):

	2019			Ending Balance
	Beginning Balance	Additions	Retirements	
Cost - Nondepreciable				
Land	\$ 352	\$ -	\$ -	\$ 352
Construction in progress	-	217	-	217
Subtotal	<u>352</u>	<u>217</u>	<u>-</u>	<u>568</u>
Cost - Depreciable				
Building	70,727	-	-	70,727
Infrastructure	929	-	-	929
Land improvements	237	-	-	237
Equipment	86,581	4,579	(367)	90,793
Leasehold improvements	818	-	-	818
Library materials	59	-	-	59
Subtotal	<u>159,351</u>	<u>4,579</u>	<u>(367)</u>	<u>163,563</u>
Total capital assets - cost	<u>159,703</u>	<u>4,795</u>	<u>(367)</u>	<u>164,131</u>
Accumulated depreciation				
Buildings	22,984	2,843	-	25,827
Infrastructure	71	15	-	87
Land improvements	52	6	-	58
Equipment	78,147	3,179	(367)	80,959
Leasehold improvements	726	6	-	732
Library materials	43	2	-	45
Subtotal	<u>102,024</u>	<u>6,052</u>	<u>(367)</u>	<u>107,708</u>
Capital assets, net	<u>\$ 57,680</u>	<u>\$ (1,257)</u>	<u>\$ -</u>	<u>\$ 56,423</u>

	2018			
	Beginning Balance	Additions	Retirements	Ending Balance
Cost - Nondepreciable				
Land	\$ 352	\$ -	\$ -	\$ 352
Subtotal	<u>352</u>	<u>-</u>	<u>-</u>	<u>352</u>
Cost - Depreciable				
Building	70,727	-	-	70,727
Infrastructure	929	-	-	929
Land improvements	237	-	-	237
Equipment	85,478	2,519	(1,416)	86,580
Leasehold improvements	818	-	-	818
Library materials	44	15	-	59
Subtotal	<u>158,232</u>	<u>2,534</u>	<u>(1,416)</u>	<u>159,351</u>
Total capital assets - cost	<u>158,585</u>	<u>2,534</u>	<u>(1,416)</u>	<u>159,702</u>
Accumulated depreciation				
Buildings	20,107	2,876	-	22,984
Infrastructure	54	15	-	71
Land improvements	46	6	-	52
Equipment	75,888	4,167	(1,372)	78,147
Leasehold improvements	720	6	-	726
Library materials	41	2	-	43
Subtotal	<u>96,859</u>	<u>6,537</u>	<u>(1,372)</u>	<u>102,023</u>
Capital assets, net	<u>\$ 61,726</u>	<u>\$ (4,003)</u>	<u>\$ (44)</u>	<u>\$ 57,680</u>

6. Other Liabilities

Other liabilities of the Research Foundation consisted of the following at June 30, 2019 and 2018 (in thousands):

	2019					
	Beginning Balance (as restated)	Additions	Retirements	Ending Balance	Current Portion	Noncurrent Portion
Other postemployment benefits	\$ 32,348	\$ -	\$ (8,396)	\$ 23,952	\$ -	\$ 23,952
Other liabilities	(39)	61	-	22	-	22
Total	<u>\$ 32,309</u>	<u>\$ 61</u>	<u>\$ (8,396)</u>	<u>\$ 23,974</u>	<u>\$ -</u>	<u>\$ 23,974</u>
	2018					
	Beginning Balance	Additions	Retirements	Ending Balance	Current Portion	Noncurrent Portion
Other postemployment benefits	\$ 33,556	\$ -	\$ (1,208)	\$ 32,348	\$ -	\$ 32,348
Other liabilities			(39)	(39)	-	(39)
Total	<u>\$ 33,556</u>	<u>\$ -</u>	<u>\$ (1,247)</u>	<u>\$ 32,309</u>	<u>\$ -</u>	<u>\$ 32,309</u>

7. Revenues From Clinical Services

a. Clinics and Laboratories

The University's Health Science Center operates various clinics, which generate revenues from the treatment of patients, as well as laboratory services. Net revenues associated with the operations of these clinics totaled approximately \$126.1 million and \$124.4 million for the years ended June 30, 2019 and 2018, respectively.

On May 10, 2019 Evolent Health Inc. (Evolent), ULP, Norton Healthcare, Inc., University Medical Center (UMC), Jewish Heritage Fund for Excellence, Inc. and Louisville Primary Care Association reached an agreement whereby Evolent would buy a 70% stake in Passport Health Plan for \$70 million. The transaction is expected to close in early fiscal 2020. In connection to the pending sale, UMC agreed to pay the Research Foundation an additional \$15.0 million for mission support of the Medical School. The additional support is to be used to offset prior and foreseen in Medical School practices. The funds were recorded as a receivable at June 30, 2019.

b. University of Louisville School of Medicine Practice Plan (the Plan)

The Plan requires each clinical department of the University of Louisville, School of Medicine to establish a departmental entity, which bears the financial obligation pursuant to the Plan. The departmental entity must receive contributions from the faculty practice groups and remit the contributions as specified in the Plan.

The Dean's Fund is collected from departmental entities and is used by the Dean to provide additional support for the clinical, academic programs and other activities of the Medical School. Amounts remitted to the Research Foundation for the Dean's Fund totaled approximately \$1.0 million and \$0.8 million for the years ended June 30, 2019 and 2018, respectively.

c. KentuckyOne Health, Inc. Affiliation Agreement

In November, 2012, the University and KentuckyOne Health, Inc. (KentuckyOne) entered into an agreement that calls for, among other things, KentuckyOne to provide funding (salary, benefits, and malpractice coverage) for certain full-time equivalent resident positions over the term of the affiliation agreement at University of Louisville Hospital (Hospital). Funding for residents is determined annually and takes into account (a) staffing at comparable academic medical centers, (b) the services provided by the Hospital, and (c) the clinical load at the Hospital and related facilities. Funding from the affiliation agreements for the years ended June 30, 2019 and 2018 was approximately \$16.7 million and \$18.0 million, respectively.

d. Norton Healthcare

In December 17, 2015, Norton Healthcare, Inc., (Norton) and the University of Louisville and the Commonwealth of Kentucky agreed to a First Amendment to Lease and a First Amendment to Master Affiliation Agreement. These agreements provide for \$30.0 million annual support payments from Norton to the University and its affiliates through Individual Agreements for research, academic support, residences and fellowships and related costs. This include our affiliation with University of Louisville Physicians (ULP) and University of Louisville Medical Center (UMC). In addition, the agreement stipulates that Norton provide additional financial support to the University of Louisville Pediatrics Department of \$24.0 million over eight years and expend at least \$35.0 million in facility improvements and other capital expenditures at Kosair Children's Hospital. Payments received by the University and its affiliates are included in clinical services and practice plan revenues in the statements of revenues, expenses, and changes in net position. Funding for the agreement for the years ended June 30, 2019 and 2018 was \$41.2 million and \$39.4 million, respectively.

On June 20, 2019, the University approved a non-binding letter of intent with ULP and Norton Healthcare (Norton) to transition the management of the University pediatrics' clinical activities to Norton. The agreement is expected to be finalized in early 2020 and will develop closer alignment of pediatric resources and services for the benefit of children's health.

In connection with the transition of the pediatric clinical enterprise, Norton agreed to pay the University up to \$15 million to cover incremental costs it will incur up to closing of the transaction to maintain operations at an agreed upon level. Norton paid \$10 million to the University to cover transition costs through June 30, 2019 which was recorded as clinical revenue by the University in its 2019 financial statements.

e. University Medical Center

The University has an academic affiliation agreement with UMC for the purpose of advancing the University's academic, education and research missions, providing quality patient care regardless of ability to pay and assurance that state-of-the-art facilities will be available for providing healthcare to patients. University employees, residents and students provide medical care utilizing UMC facilities, in return, UMC receives revenues for the services provided. UMC provides support to the University through annual funding for salaries, benefits and insurance coverage, annual academic support and annual departmental/administrative support pursuant to the terms of the master support and services agreement. For the years ending June 30, 2019 and 2018, support totaling approximately \$46.2 million and \$47.5 million, respectively, was received under these agreements.

f. Other Clinical Revenues

The Research Foundation works with other area hospitals by providing support services, such as residents and other staff. Revenues associated with these activities totaled approximately \$15.8 million and \$18.2 million for the years ended June 30, 2019 and 2018, respectively.

8. Expenses

Operating expenses by natural classification for the years ended June 30, 2019 and 2018 were approximately (in thousands):

	<u>2019</u>	<u>2018</u>
Salaries and wages	\$ 234,756	\$ 228,360
Employee benefits	54,621	52,378
Supplies and services	103,467	96,592
Depreciation	6,052	6,537
Scholarships and fellowships	48,138	44,493
Total	<u>\$ 447,034</u>	<u>\$ 428,360</u>

9. Retirement Plan

University personnel participate in a contributory retirement plan administered by the University. The University of Louisville 403(b) Retirement Plan (Retirement Plan) was established by the University and approved by the Board of Trustees. Permanent, full-time employees become eligible to participate in a defined contribution plan upon completion of one year's service and attainment of age 21. Eligible employees not contributing to the Retirement Plan are entitled to a 7.5% of base salary contribution on their behalf by the University. The University also matches up to an additional 2.5% of employee contributions. The Retirement Plan requires three years of continuous service for employees to vest in employer contributions.

The Research Foundation recorded expenses related to the defined contribution plan of approximately \$15.2 million and \$14.8 million during the years ended June 30, 2019 and 2018, respectively. As of June 30, 2019 and 2018, the Research Foundation had no outstanding liability related to the Retirement Plan.

10. Postemployment Healthcare Benefits

a. Plan Description

University and Association personnel are eligible for postemployment healthcare benefits as described in The University of Louisville Group Health Plan (Plan), administered by the University. The Plan is a single-employer plan and the University's Board of Trustees determines the eligibility requirements related to the Plan. The Plan does not issue stand-alone financial reports and is not included in the report of any entity.

To be eligible for the Plan, a retired employee must be the earlier of the attainment of age 60 with seven years of service in eligible faculty or staff status, or the date that the sum of the employee's age and years of regular service of not less than 80% full-time equivalent at the University equals or exceeds 75.

At July 1, 2018, the following employees were covered by the benefit terms.

Inactive plan members	1,513
Active plan members	<u>5,482</u>
Total	<u><u>6,995</u></u>

b. Funding Policy

The Plan is funded on a pay-as-you-go basis. The contribution requirements of the contributing members are determined by the University's management on an annual basis. During the years ended June 30, 2019 and 2018, the University contributed approximately \$2.8 million and \$3.3 million to the Plan, approximately 68% and 75% of total premiums, respectively. Retired Plan members under age 65 receiving benefits contributed approximately \$1.3 million and \$1.1 million, approximately 32% and 25% of total premiums for the years ended June 30, 2019 and 2018, respectively, through their required monthly contributions according to the schedules below:

	2019			
	<u>PPO</u>	<u>EPO</u>	<u>PCA High</u>	<u>PCA Low</u>
Employee	\$ 342	\$ 362	\$ 288	\$ 254
Employee and Spouse	\$ 830	\$ 870	\$ 710	\$ 570
	2018			
	<u>PPO</u>	<u>EPO</u>	<u>PCA High</u>	<u>PCA Low</u>
Employee	\$ 335	\$ 353	\$ 281	\$ 248
Employee and Spouse	\$ 811	\$ 851	\$ 692	\$ 555

Medicare-eligible retirees receive a monthly benefit of \$108 per individual covered. For the years ended June 30, 2019 and 2018, the University contributed \$1.8 million and \$1.9 million for Medicare-eligible retirees, respectively.

c. Annual Other Postemployment Benefit (OPEB) Cost and Net OPEB Obligation

The University's total OPEB liability was measured by an actuarial valuation as of June 30, 2018. The total OPEB liability in the June 30, 2018 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified.

Inflation	3.87%
Salary Increases	5.00%, average
Investment rate of return	NA
	7.7% for 2018, decreasing 0.4%-0.5% per year to an ultimate rate of
Healthcare cost trend rates	4.5% for 2027 and later years

The investment rate of return is shown as not applicable (NA) since the University contributes only the amount necessary to pay current benefits. The discount rate is 3.58% as of the Measurement Date, 3.87% as of the beginning of the Measurement Period.

The following table shows the components of the University's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the University's net OPEB obligation (in thousands):

	<u>6/30/2019</u>
Total OPEB liability	
Service Cost	\$ 4,630
Interest	3,296
Difference between expected and actual experience	(1,718)
Changes of assumption	(27,504)
Benefit payments	(2,817)
Net change in OPEB Liability	(24,113)
OPEB liability - beginning of year	88,843
OPEB liability - end of year	<u>\$ 64,730</u>

Covered employee payroll \$ 450,332

Total OPEB liability as a percentage of covered employee payroll 14.37%

The following reflects the sensitivity of the net OPEB liability to changes in the discount rate and healthcare cost trend rate. The schedule below presents the University's OPEB liability, as well as what the University's OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower or 1 percentage point higher than the current discount rate (in thousands):

	<u>1% Decrease</u> <u>(-2.87)%</u>	<u>Discount Rate</u> <u>(-3.87)%</u>	<u>1% Increase</u> <u>(-4.87)%</u>
Net OPEB Liability	70,923	64,730	59,231

The schedule below presents the University's OPEB liability, as well as what the University's OPEB liability would be if it were calculated using a healthcare cost trend rate that is 1 percentage point lower (6.7% for 2018, decreasing 0.4%-0.5% per year to an ultimate rate of 3.5% for 2026) or 1 percentage point higher (8.7% for 2018, decreasing 0.4%-0.5% per year to an ultimate rate of 5.5% for 2026) than the current healthcare cost trend rate (In thousands):

	1% Decrease	Healthcare Cost Trend Rate	1% Increase
	6.7%	7.7%	8.7%
Net OPEB Liability	<u>62,057</u>	<u>64,730</u>	<u>67,882</u>

For the year ended June 30, 2019 the University recognized OPEB expense of \$3,722. At June 30, 2019, the University reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources (in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ -	\$ (3,525)
Changes of assumptions	-	(28,649)
Contributions made in fiscal year ending 6/30/2018 after the measurement date of 6/30/2019	<u>2,836</u>	<u>-</u>
Total	<u>\$ 2,836</u>	<u>\$ (32,174)</u>

The amount reported as contributions after the measurement date included in deferred outflows will be recognized as benefit payments during the following fiscal year.

Amounts reported as differences between expected and actual experience and changes in assumptions included under deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows on the following page (in thousands):

<u>Fiscal Year Ended</u>	
<u>June 30:</u>	
2020	\$ (4,204)
2021	(4,204)
2022	(4,204)
2023	(4,204)
2024	(4,204)
Thereafter	(4,154)

d. **Funded Status and Funding Progress**

As of June 30, 2018, the most recent actuarial valuation date, the plan was 0% funded. The unfunded OPEB liability for benefits was \$64.7 million and \$88.8 million and there were no assets, resulting in an unfunded net OPEB liability of \$64.7 million and \$88.8 million as of June 30, 2019 and 2018, respectively. The covered payroll (annual payroll of active employees covered by the plan) was \$450.3 million and \$445.4 million, and the ratio of the unfunded net OPEB liability to the covered payroll was 14% and 20%, for the years ended June 30, 2019 and 2018, respectively.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations.

e. Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the June 30, 2018, actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included an annual healthcare cost trend rate of 7.7% initially, reduced by decrements to an ultimate rate of 4.5 percent after 10 years. The gains on the benefit obligation recognized during the fiscal years ended June 30, 2019 and 2018 were due to updates made on expected future health claims and an increase in the discount rate from 2.85% as of the beginning of the reporting year to 3.58% as of the measurement date, and changes in the assumed per capita cost.

11. Commitments and Contingencies

a. Commitments

At June 30, 2019 and 2018, respectively, the Research Foundation had approximately \$1.2 million and \$1.0 million in encumbrance's outstanding related mainly to operational expenses for future expenditures.

b. Litigation

The University has been named as defendant in several lawsuits, including several actions initiated by patients involving alleged malpractice. It is the opinion of management and its legal counsel, based in part on the doctrine of sovereign immunity, commercial insurance coverages and other statutory provisions, that the ultimate outcome of litigation will not have a material effect on the future operations or financial position of the University or the Research Foundation beyond the amounts already provided.

c. Government Grants

The Research Foundation is currently participating in numerous grants from various departments and agencies of the federal and state governments. The expenditure of grant proceeds must be for allowable and eligible purposes. Single audits and audits by the granting department or agency may result in requests for reimbursement of unused grant proceeds or disallowed expenditures. Upon notification of final approval by the granting department or agency, the grants are considered closed

12. Subsequent Events

On August 14, 2019, the University announced an agreement for the purchase of KentuckyOne Health (KOH) assets from its parent company CommonSpirit Health (CSH). The purchase price for the assets is \$10 million plus or minus a working capital adjustment and in return, CSH will forgive UMC's debt of \$19.4 million. CSH will also provide UofL an estimated \$76.4 million of net working capital to provide initial capital needed to transition and turn around the operations of the KOH. The University's purchase of KOH is to be assigned to UMC.

The acquisition is being funded through a combination of private foundation support of \$50 million, a Commonwealth of Kentucky Economic Development Loan of \$50 million and target working capital as a requirement of the acquisition of \$76.4 million. The agreement is expected to close on November 1, 2019.

REQUIRED SUPPLEMENTARY INFORMATION
Schedule of Changes in Total OPEB Liability and Related Ratios
For the Fiscal Year Ending
(in thousands)

	<u>6/30/2019</u>	<u>6/30/2018</u>
Total OPEB liability		
Service Cost	\$ 4,630	\$ 5,204
Interest	3,296	2,728
Difference between expected and actual experience	(1,718)	(2,608)
Changes of assumption	(27,504)	(5,495)
Benefit payments	<u>(2,817)</u>	<u>(3,007)</u>
Net change in OPEB Liability	(24,113)	(3,178)
OPEB liability - beginning of year	88,843	92,022
OPEB liability - end of year	<u>\$ 64,730</u>	<u>\$ 88,844</u>
Covered employee payroll	\$ 450,332	\$ 445,356
Total OPEB liability as a percentage of covered employee payroll	14.37%	19.95%

This schedule is to be built prospectively. Until a full 10-year trend is compiled, the schedule will show information for those years for which data is available.