

UNIVERSITY OF LOUISVILLE RESEARCH FOUNDATION, INC.

A Component Unit of the University of Louisville

**Auditor's Report and Financial Statements
June 30, 2013 and 2012**

UNIVERSITY OF LOUISVILLE RESEARCH FOUNDATION, INC.

A Component Unit of the University of Louisville

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Independent Auditor's Report on Financial Statements and Supplementary Information

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

We have audited the accompanying basic financial statements, which are comprised of statements of net position as of June 30, 2013 and 2012, and statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the financial statements, as listed in the table of contents, of the University of Louisville Research Foundation, Inc. (Research Foundation), a component unit of the University of Louisville.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Research Foundation'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 Research Foundation'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 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 financial position of the Research Foundation as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 11 to the financial statements, the 2012 financial statements have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

Required Supplementary Information

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

BKD, LLP

Louisville, Kentucky
October 2, 2013

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, 2013, 2012, and 2011. 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 non-profit corporation affiliated with the University of Louisville (University), a state-supported research university located in Kentucky's largest metropolitan area. 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 progressed steadily towards the goals established by the Kentucky Council on Postsecondary Education. During the fiscal year ended June 30, 2013, total awards were \$118.9 million, a decrease of \$2.3 million or 2%, as compared to fiscal year 2012. This decrease is partially attributed to a reduction in federal grant stimulus supplements. Some of the funding highlights include:

- \$6.5 million from the Kentucky Council on Postsecondary Education for Tobacco Tax Funding-Cancer Research Institute
- \$3.8 million from the Kentucky Council on Postsecondary Education for Kentucky Lung Cancer Research Program Funding
- \$3.3 million from the National Institute for Health (NIH) for the National Children's Study-Jefferson County, KY
- \$2.8 million from the NIH Kentucky IDeA Networks of Biomedical Research Excellence
- \$2.4 million from the NIH for Protection of Ischemic Myocardium
- \$2.4 million from SCR Development Group, Inc. for Speed Bio-engineering testing SCR SVAD Cannula System

Research Foundation faculty continue to receive national recognition, as one chemistry professor was named a 2014 Fulbright Distinguished chair and two pediatricians were chosen to serve on prestigious national American Academy of Pediatrics committees. Additionally, a faculty member in the Department of Neurosurgery has been named to a section of the NIH's Center for Scientific Review, which makes recommendations on neurological research funding.

Financial Highlights

- The Research Foundation's financial position remains strong at June 30, 2013, with total assets of \$118.6 million and liabilities of \$31.1 million as compared to June 30, 2012 at \$143.0 million of total assets and \$34.2 million of liabilities. Net position, which represent the residual interest in the Research Foundation's assets after liabilities are deducted, were \$87.5 million and \$108.8 million for the years ended June 30, 2013 and 2012, respectively.

- The Research Foundation's total liabilities of \$31.1 million contain grant advances. Grant advances represent the unearned portion of grants and sponsored programs and comprise \$10.5 million or 34% of total liabilities.
- Operating revenues amounted to \$291.9 million and \$315.8 million and operating expenditures were \$358.4 million and \$363.2 million resulting in a net operating loss of \$66.5 million and \$47.4 million for the years ended June 30, 2013 and 2012, respectively. When adjusted for net nonoperating revenues of \$45.3 million and \$20.1 million, net position of the Research Foundation decreased by \$21.2 million and \$27.3 million for the years ended June 30, 2013, and 2012, respectively.

Using the Financial Statements

The Research Foundation's financial report includes three financial statements: 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 \$39.7 million and \$40.9 million in nonexchange grants and contract revenue for the years ended June 30, 2013 and 2012, 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 advances totaled \$10.5 million for each of the fiscal years ended June 30, 2013 and 2012, respectively.
- Capital assets are depreciated and reported net of accumulated depreciation. The Research Foundation's capital assets as of June 30, 2013 and 2012 consist primarily of buildings, equipment and library materials with a net position value of \$72.4 million and \$77.6 million, 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 and liabilities. Net position represents the difference between total assets and total liabilities and provides a snapshot of the current financial condition of the Research Foundation at the end of a fiscal year. The change in net position indicates whether the overall financial condition has improved or worsened during the year. Assets and liabilities are generally measured using current values. 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, 2013, 2012, and 2011 is summarized below:

Condensed Statements of Net Position
June 30, 2013, 2012, and 2011
(In Thousands)

	<u>2013</u>	<u>Restated 2012</u>	<u>Restated 2011</u>	<u>2013 - 2012 Change</u>	<u>2012 - 2011 Change</u>
ASSETS					
Current assets	\$ 45,052	\$ 64,965	\$ 94,451	\$ (19,913)	\$ (29,486)
Capital assets	72,405	77,567	78,030	(5,162)	(463)
Other noncurrent assets	1,161	489	390	672	99
Total assets	<u>118,618</u>	<u>143,021</u>	<u>172,871</u>	<u>(24,403)</u>	<u>(29,850)</u>
LIABILITIES					
Current liabilities	23,098	27,493	30,223	(4,395)	(2,730)
Noncurrent liabilities	7,979	6,753	6,554	1,226	199
Total liabilities	<u>31,077</u>	<u>34,246</u>	<u>36,777</u>	<u>(3,169)</u>	<u>(2,531)</u>
NET POSITION					
Net investment in capital assets	72,406	77,567	78,030	(5,161)	(463)
Restricted - expendable	4,386	4,651	2,438	(265)	2,213
Unrestricted	10,749	26,557	55,626	(15,808)	(29,069)
Total net position	<u>\$ 87,541</u>	<u>\$ 108,775</u>	<u>\$ 136,094</u>	<u>\$ (21,234)</u>	<u>\$ (27,319)</u>

Assets

A review of the Research Foundation's statement of net position at June 30, 2013 indicates that the Research Foundation is highly liquid with only \$8.0 million in long-term liabilities. Of the \$45.1 million in current assets, \$22.0 million, or 49%, consists of cash and cash equivalents. Accounts receivable that are to be collected within the next year represent \$22.3 million, or 49% of total current assets. As detailed in the Statements of Cash Flows, the cash decreased during the year by \$17.1 million due mainly to decreases in funding from grants and clinical services.

Noncurrent assets consist mainly of \$72.4 million of capital assets, which decreased due to additional depreciation on the assets.

Liabilities

The Research Foundation's current liabilities consist mainly of \$10.5 million of unexpended cash advances for sponsored research activities, similar to June 30, 2012. 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 \$12.6 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 \$9.3 million, with the \$1.3 million current portion included in accounts payable and accrued expenses and the remainder shown as other long-term liabilities.

Net Position

Net position represent the residual interest in the Research Foundation's assets after liabilities are deducted. The Research Foundation's net position at June 30, 2013 and 2012 was \$87.5 million and \$108.8 million, respectively. They are 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 - \$72.4 million

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. The \$5.2 million decrease over prior year reflects the addition of \$4.3 million in capital assets, offset by \$9.5 million of depreciation.

Restricted expendable net position - \$4.4 million

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, 2013. The amounts remain restricted until the contract is completed.

Restricted expendable net position decreased \$0.3 million, or 6%. The overall decrease is due mainly to a decrease in the number of grant awards.

Unrestricted net position - \$10.7 million

Unrestricted net position results primarily from net operating income derived from clinical services and fixed contract revenues in excess of actual expenses. Although unrestricted net position is not subject to externally imposed stipulations, substantially all of the Research Foundation's unrestricted net position has been designated for various academic and research programs and initiatives.

Fiscal Year 2012

The Research Foundation's financial position as of the fiscal year ended June 30, 2012 shows a decrease in assets and liabilities with an overall decrease in net position. Assets decreased during the fiscal year ended June 30, 2012 by \$29.9 million, or 17%, as compared to the fiscal year ended June 30, 2011. This decrease was due mainly to the \$30.4 million decrease in cash and cash equivalents. The decrease in liabilities mainly resulted from the decrease in grant advances, which decreased \$4.2 million from the fiscal year ended June 30, 2011, due to a general decline in the amount of grants awarded.

Net position decreased \$27.3 million, or 20%, compared to net position at June 30, 2011 due mainly to the \$29.1 million decrease in unrestricted net position.

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, 2013, 2012, and 2011 is shown on the following page:

Condensed Statements of Revenues, Expenses and Changes in Net Position
Years ended June 30, 2013, 2012, and 2011
(In Thousands)

	<u>2013</u>	<u>Restated 2012</u>	<u>Restated 2011</u>	<u>2013 - 2012 Change</u>	<u>2012 - 2011 Change</u>
OPERATING REVENUES					
Clinical services	\$ 173,986	\$ 181,791	\$ 197,124	\$ (7,805)	\$ (15,333)
Grants and contracts	92,488	106,189	107,991	(13,701)	(1,802)
Facilities and administrative cost recoveries	24,011	26,899	27,582	(2,888)	(683)
Other operating revenues	1,434	908	1,166	526	(258)
Total operating revenues	<u>291,919</u>	<u>315,787</u>	<u>333,863</u>	<u>(23,868)</u>	<u>(18,076)</u>
OPERATING EXPENSES					
Depreciation	9,481	10,091	9,605	(610)	486
Other operating expenses	348,976	353,077	333,828	(4,101)	19,249
Total operating expenses	<u>358,457</u>	<u>363,168</u>	<u>343,433</u>	<u>(4,711)</u>	<u>19,735</u>
Operating loss	<u>(66,538)</u>	<u>(47,381)</u>	<u>(9,570)</u>	<u>(19,157)</u>	<u>(37,811)</u>
NONOPERATING REVENUES (EXPENSES)					
Gifts	67	37	663	30	(626)
Nonexchange grants and contracts	39,733	40,885	38,563	(1,152)	2,322
Realized and unrealized gain on investments	-	-	610	-	(610)
Transfers	(10,893)	(15,447)	(14,299)	4,554	(1,148)
Other nonoperating revenues	16,397	(5,413)	1,226	21,810	(6,639)
Total nonoperating revenues	<u>45,304</u>	<u>20,062</u>	<u>26,763</u>	<u>25,242</u>	<u>(6,701)</u>
(Decrease)/increase in net position	<u>(21,234)</u>	<u>(27,319)</u>	<u>17,193</u>	<u>6,085</u>	<u>(44,512)</u>
NET POSITION					
Net position, beginning of year, as previously reported	108,775	136,094	123,442	(27,319)	12,652
Adjustment applicable to prior year (the year ended June 30, 2010)	-	-	(4,541)	-	4,541
Net position, beginning of year as restated	<u>108,775</u>	<u>136,094</u>	<u>118,901</u>	<u>(27,319)</u>	<u>17,193</u>
Net position, end of year	<u>\$ 87,541</u>	<u>\$ 108,775</u>	<u>\$ 136,094</u>	<u>\$ (21,234)</u>	<u>\$ (27,319)</u>

Operating Revenues

The Research Foundation recognized \$291.9 million in operating revenues for the year ended June 30, 2013. This represents an 8% decrease in revenues from the \$315.8 million reported for the year ended June 30, 2012.

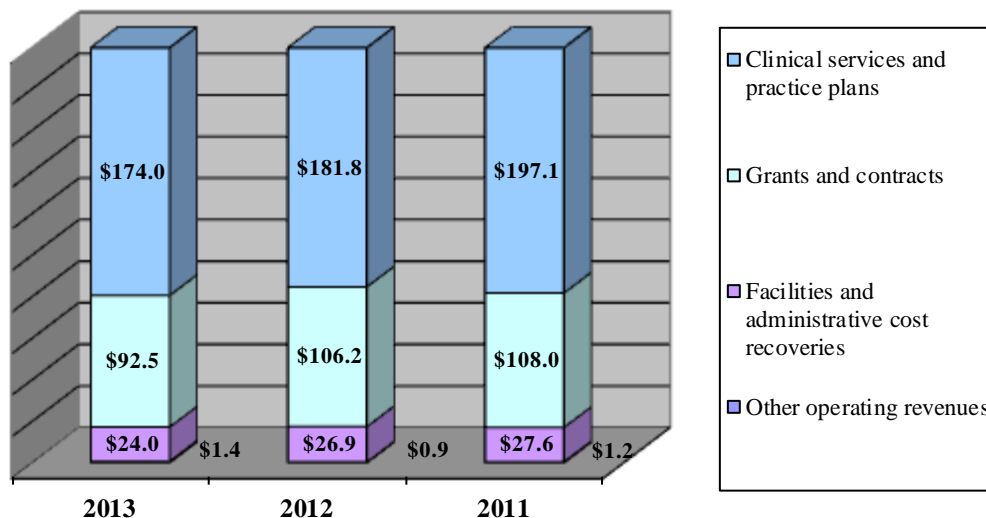
Revenues from clinical services were \$174.0 million for the year ended June 30, 2013. This is a decrease of approximately \$7.8 million, or 4%, compared to \$181.8 million in similar revenues reported for the year ended June 30, 2012. The decrease in revenues is due mainly to a \$15.8 million decrease in clinical operations as the kidney disease program was sold to a third party on June 30, 2012 and other units moved to University of Louisville Physicians, Inc. (ULP) during the year. This decrease was offset by the \$4.7 million increase in Academic Program Support funds from the Practice Plans and \$3.5 million increase in amounts received from affiliation agreements with area hospitals. For the years ended June 30, 2013 and 2012, revenues earned for clinical services are reported net of \$5.4 million and \$37.9 million, respectively, in contractual allowances related to federal, state and private insurance providers. The \$32.5 million decrease is related to the sale of the kidney disease program.

Revenues from grants and contracts were \$92.5 million for the year ended June 30, 2013 as compared to \$106.2 million in revenues reported in the previous year. This includes decreases of \$9.6 million in federal grants, \$1.5 million in state and local grants and \$2.7 million in nongovernmental grants for the year ended June 30, 2013, as compared to the previous year. The decreases resulted from continued decreases in research funding and the impact of sequestration.

Revenue from facilities and administrative cost recoveries were \$24.0 million and \$26.9 million for the years ended June 30, 2013 and 2012, respectively. This represents the reduction in collection of a contractually agreed upon percentage applied to the grant reimbursements in lieu of calculating fees for indirect costs, such as general and administrative expenses, use of buildings and labs or utilities. The Research Foundation, in turn, compensates the University for a portion of the cost recoveries in support of those expenditures. For the years ended June 30, 2013 and 2012, approximately \$10.5 million and \$11.2 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, 2013, 2012, and 2011 (in millions).

**Operating Revenues
Years Ended June 30, 2013, 2012, and 2011**

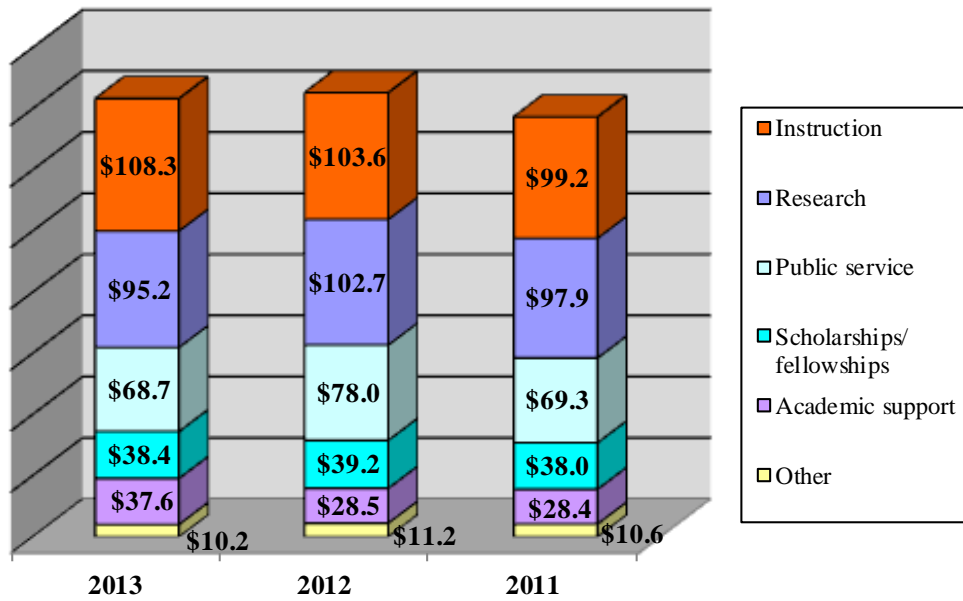


Operating Expenses by Functional and Natural Class

Total operating expenses were \$358.4 million and \$363.2 million for the fiscal years ended June 30, 2013 and 2012, respectively. The decrease of \$4.8 million, or 1%, is mainly related to an overall decrease of \$16.8 million in research and public service expenses. Most notable is a \$7.4 million decrease in expenses related to the sale of the kidney disease program to a third party, which was included in public service expenses.

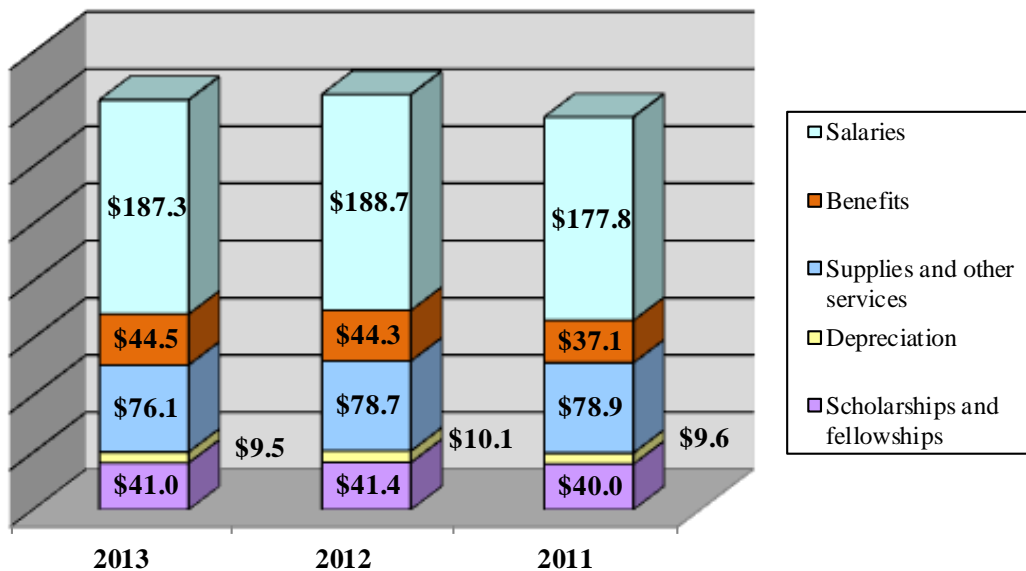
The following is a graphic illustration of total operating expenses by function for the years ended June 30, 2013, 2012 and 2011 (in millions):

Operating Expenses by Functional Classification
Years ended June 30, 2013, 2012, and 2011



The following is a graphic illustration of total operating expenses by natural classification for the years ended June 30, 2013, 2012 and 2011 (in millions):

Operating Expenses by Natural Classification
Years ended June 30, 2013, 2012, and 2011



Nonoperating Revenues (Expenses)

The Research Foundation's total nonoperating revenues of \$45.3 million for fiscal year ended June 30, 2013, was mostly comprised of nonexchange grants and contract revenues of \$39.7 million and transfer expenses of \$10.9 million. Included in the transfers total was an \$10.5 million transfer to the University, related to the facilities and administrative revenue, for administrative expenses incurred for sponsored research. Total nonoperating revenues increased by \$25.2 million as compared to fiscal year ended June 30, 2012. The increase is due mainly to the \$16.2 million of refunds received by the Research Foundation related to the employer portion of FICA tax on medical residents paid in years prior to April 2005.

Fiscal Year 2012

For the year ended June 30, 2012, Research Foundation reported \$315.8 million in operating revenues. This was a 5% decrease compared to the \$333.9 million reported for the year ended June 30, 2011

Revenues from clinical services were \$181.8 million for fiscal year 2012, a decrease of 8% from the fiscal year ended June 30, 2011. The decrease in revenues is partially related to a \$9.5 million decrease in funds received related to Medicaid programs. Revenues from grants and contracts were \$106.2 million for the year ended June 30, 2012 as compared to \$108.0 million in revenues reported in the previous year. The decrease is partially attributable to a \$9.2 million reduction in federal grants and contracts, due to a reduction in the number of grants.

Revenue from facilities and administrative cost recoveries were \$26.9 million and \$27.6 million for the years ended June 30, 2012 and 2011, respectively. This represents the collection of a contractually agreed upon percentage applied to the grant reimbursements in lieu of calculating fees for indirect costs, such as general and administrative expenses, use of buildings and labs or utilities. The Research Foundation, in turn, compensates the University for a portion of the cost recoveries in support of those expenditures. For each of the years ended June 30, 2012 and 2011, approximately \$11.2 million was transferred to the University for this purpose.

Total operating expenses were \$363.2 million and \$343.4 million for the fiscal years ended June 30, 2012 and 2011, respectively. The \$18.0 million increase in salaries and benefits is the main contributor to the overall \$19.7 million increase in expenses. This reflects the Research Foundation's efforts to secure and retain quality faculty and staff.

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, 2013, 2012, and 2011, are summarized below:

Condensed Statements of Cash Flows
Years ended June 30, 2013, 2012, and 2011
(In Thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2013 - 2012</u> <u>Change</u>	<u>2012 - 2011</u> <u>Change</u>
Cash (used)/provided by:					
Operating activities	\$ (52,859)	\$ (41,055)	\$ (7,380)	\$ (11,804)	\$ (33,675)
Noncapital and related financing activities	40,194	20,237	26,175	19,957	(5,938)
Capital financing activities	(4,412)	(9,654)	(13,072)	5,242	3,418
Investing activities	-	35	4,310	(35)	(4,275)
Net (decrease)/increase in cash	<u>(17,077)</u>	<u>(30,437)</u>	<u>10,033</u>	<u>13,360</u>	<u>(40,470)</u>
Cash and cash equivalents, beginning of year	<u>39,039</u>	<u>69,476</u>	<u>59,443</u>	<u>(30,437)</u>	<u>10,033</u>
Cash and cash equivalents, end of year	<u>\$ 21,962</u>	<u>\$ 39,039</u>	<u>\$ 69,476</u>	<u>\$ (17,077)</u>	<u>\$ (30,437)</u>

Operating Activities

The Research Foundation operating activities used approximately \$52.9 million representing an increase of \$11.9 million during in the fiscal year ended June 30, 2013, due to a \$6.9 million decrease in cash received from clinical services, which relates to the sale of the kidney disease program and movement of other clinical units to ULP. Additionally, cash provided by grants decreased by \$6.4 million due to the lower number of grants. Cash outflows from operations during the fiscal year ended June 30, 2013 decreased due largely to expenses related to payments to employees, which decreased \$1.2 million, as compared to the fiscal year ended June 30, 2012.

Other Activities

The \$40.2 million cash provided by noncapital and related financing activities relates mainly to the \$39.2 million provided by nonexchange grants. It also includes the Research Foundation's payment of \$10.5 million to the University as reimbursement for indirect charges to support the use of buildings and labs. In total, cash provided by noncapital and related financing activities increased \$20.0 million from the fiscal year ended June 30, 2012, due in part to the receipt of \$11.6 million of refunds of the employer portion of FICA tax paid for medical residents prior to April 2005.

Cash used for capital financing activities decreased \$5.2 million to \$4.4 million during the fiscal year ended June 30, 2013, due to a decrease in the amount of capital assets purchased.

Fiscal Year 2012

The Research Foundation's cash and cash equivalents decreased by \$30.4 million during the fiscal year ended June 30, 2012. The Research Foundation's operating activities used approximately \$41.1 million in net cash due mainly to a \$15.7 million increase in payments for salaries and benefits. Cash received from grants and contracts decreased by \$10.0 million as compared to fiscal year ended June 30, 2011.

Cash outflows from operations during the fiscal year ended June 30, 2012, were \$351.2 million. This was an increase of \$13.0 million as compared to the fiscal year ended June 30, 2011. Cash outflows from operations during the fiscal year ended June 30, 2012 increased due largely to expenses related to payments to employees, which increased \$11.7 million, and payments for benefits, which increased \$3.9 million, as compared to the fiscal year ended June 30, 2011.

The \$20.2 million cash provided by noncapital and related financing activities relates mainly to the \$41.0 million provided by nonexchange grants. It also includes the Research Foundation's payment of \$11.2 million to the University as reimbursement for indirect charges to support the use of buildings and labs.

Economic Factors that May Affect the Future

As mandated by House Bill 1, the University is to become a nationally recognized metropolitan research university. The next important step towards achieving that mandate was the Fall 2008 introduction of the 2020 Plan. The 2020 Plan is the strategic blueprint for the University to achieve House Bill 1's mandate. This plan was drafted after the Board of Trustees instructed President James Ramsey to aggressively move ahead towards the next level in the University's pursuit of excellence.

The University has faced many fiscal challenges that have impacted campus operations both prior to, and subsequent to The 2020 Plan's introduction. The most recent recession of December 2007–June 2009 has exacerbated the decline in state general fund support. State appropriations in constant dollars have decreased each year from fiscal year 2008, the beginning of the recession, through the current fiscal year 2014 budget. The constant dollar decrease for this period is 25.8%, nearly one-quarter of fiscal year 2008 levels. The effect on constant dollar State Appropriation per Full-Time Equivalent (FTE) student has been even more dramatic during this period; a decrease of 31.8%.

The 2012-14 biennial budget passed by the 2012 General Assembly in May 2012 reflected a net 6.4% reduction, or \$9.7 million, in state support for the University in fiscal year 2013. The fiscal year 2014 budget was flat lined from fiscal year 2013.

The reduced state funding continues to impact daily operations. The University hasn't received maintenance and operation funding for new buildings in several years. The University has been unable to fund a permanent salary increase in three of the past six fiscal years.

The budgetary decisions that support and shape the fiscal year 2014 proposed budget reflect the current and foreseeable economic realities facing public higher education institutions in general and the University in particular.

Because of the changing landscape of higher education across the United States, the University has embarked on a consultative process aimed at re-shaping and re-engineering the University. The "21st Century Initiative," led by the University Provost, is a broad-based, campus-wide initiative to position the University to meet not only the 2020 Plan goals, but to also address ways to better serve students and the community for decades to come.

This year, the annual budget focused on the University's "Upward Trajectory". Despite thirteen budget cuts in twelve years, the lack of maintenance and operations funding, and the dramatic shift in public policy that has, and continues to redirect funding away from higher education, the University has made tremendous progress in meeting its 2020 goals. The President outlined the University's successes across a myriad of key academic, research, and public service metrics, noting; "it's not just about the numbers, it's about the people." These successes, the result of hard work by the University's faculty, staff and students, has the University well positioned to meet House Bill 1's aggressive mandate to become a preeminent metropolitan research university.

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, 2013 and 2012
(In Thousands)

	2013	Restated 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 21,962	\$ 39,039
Accounts receivable, net	22,307	24,972
Inventories	361	409
Other assets	422	545
Total current assets	45,052	64,965
Noncurrent Assets:		
Accounts receivable, net	1,159	485
Other long-term assets	2	4
Capital assets, net	72,405	77,567
Total noncurrent assets	73,566	78,056
Total assets	118,618	143,021
LIABILITIES		
Current Liabilities:		
Accounts payable and accrued liabilities	12,588	17,012
Grant advances	10,510	10,481
Total current liabilities	23,098	27,493
Noncurrent Liabilities:		
Other long-term liabilities	7,979	6,753
Total noncurrent liabilities	7,979	6,753
Total liabilities	31,077	34,246
NET POSITION		
Net investment in capital assets	72,406	77,567
Restricted - expendable for:		
Research	3,489	3,936
Instruction	448	520
Public service	252	53
Scholarships and fellowships	189	133
Academic support	8	9
Unrestricted	10,749	26,557
Total net position	\$ 87,541	\$ 108,775

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, 2013 and 2012
(In Thousands)

	<u>2013</u>	<u>Restated 2012</u>
OPERATING REVENUES		
Clinical services, net of contractual allowances of \$5,389 in 2013 and \$37,888 in 2012	\$ 173,986	\$ 181,791
Federal grants and contracts	71,919	81,481
State and local grants and contracts	10,698	12,148
Nongovernmental grants and contracts	9,871	12,560
Other operating revenue	1,434	908
Facilities and administrative cost recoveries	24,011	26,899
Total operating revenues	<u>291,919</u>	<u>315,787</u>
OPERATING EXPENSES		
Instruction	108,274	103,603
Research	95,229	102,705
Public service	68,681	77,991
Scholarships and fellowships	38,416	39,191
Academic support	37,626	28,525
Institutional support	648	741
Operation and maintenance of plant	71	315
Depreciation	9,481	10,091
Student services	11	-
Service centers	20	6
Total operating expenses	<u>358,457</u>	<u>363,168</u>
Operating loss	<u>(66,538)</u>	<u>(47,381)</u>
NONOPERATING REVENUES (EXPENSES)		
Gifts	67	37
Nonexchange grants and contracts	39,733	40,885
Investment loss	5	-
Other nonoperating income/(expense)	16,392	(5,413)
Net nonoperating revenues	<u>56,197</u>	<u>35,509</u>
Transfers	<u>(10,893)</u>	<u>(15,447)</u>
Total other revenues	<u>45,304</u>	<u>20,062</u>
Decrease in net position	<u>(21,234)</u>	<u>(27,319)</u>
NET POSITION		
Net position - beginning of year, as previously reported	108,775	140,635
Adjustment applicable to prior year (the year ended June 30, 2010)	-	(4,541)
Net position - beginning of year, as restated	<u>108,775</u>	<u>136,094</u>
Net position - end of year	<u>\$ 87,541</u>	<u>\$ 108,775</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, 2013 and 2012
(In Thousands)

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Clinical services	\$ 173,880	\$ 180,798
Grants and contracts	95,152	101,551
Facilities and administrative cost recoveries	24,011	26,899
Other operating revenue	1,434	850
Payments to employees	(187,892)	(189,061)
Payments for benefits	(43,428)	(43,989)
Payments for scholarships and fellowships	(40,991)	(41,424)
Payments to suppliers	(75,025)	(76,679)
Net cash used by operating activities	<u>(52,859)</u>	<u>(41,055)</u>
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES		
Transfers to related entities	(10,934)	(15,447)
Gifts	67	37
Nonexchange grants and contracts	39,205	41,061
Other noncapital financing activity	11,856	(5,414)
Net cash provided by noncapital and related financing activities	<u>40,194</u>	<u>20,237</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchases of capital assets	(4,412)	(9,654)
Net cash used by capital and related financing activities	<u>(4,412)</u>	<u>(9,654)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Sales of investments	-	35
Net cash provided by investing activities	<u>-</u>	<u>35</u>
Net decrease in cash and cash equivalents	(17,077)	(30,437)
Cash and cash equivalents - beginning of year	39,039	69,476
Cash and cash equivalents - end of year	<u>\$ 21,962</u>	<u>\$ 39,039</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating loss	\$ (66,538)	\$ (47,381)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation	9,481	10,090
Loss on disposal of equipment	129	26
Changes in assets and liabilities:		
Accounts receivable, net	2,527	(1,488)
Inventories	48	64
Other assets	123	165
Accounts payable and accrued liabilities	116	1,469
Grant advances	29	(4,199)
Other long-term liabilities	1,226	199
Net cash used by operating activities	<u>\$ (52,859)</u>	<u>\$ (41,055)</u>
NONCASH TRANSACTIONS		
Proceeds from sale of capital assets in accounts receivable	\$ -	\$ 149
Transfer of assets from University of Louisville	<u>\$ 42</u>	<u>\$ -</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, 2013 and 2012

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 included within 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).

During the year ended June 30, 2013, the Research Foundation adopted Statement of Governmental Accounting Standards Board (GASB) No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in Paragraph 7 of that statement for business-type activities to apply post-November 30, 1989, FASB statements and interpretations that do not conflict with or contradict GASB pronouncements. GASB No. 62 has been applied retrospectively and had no impact on the Research Foundations's net position or changes in net position and minimal changes to financial reporting disclosures.

During the year ended June 30, 2013, the Research Foundation adopted GASB Statement No. 61, *The Financial Reporting Entity: Omnibus, An Amendment of GASB Statements No.14 and No. 34*, which had no impact on the Research Foundation's financial statements.

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

b. Cash and Cash Equivalents

The Research Foundation considers all investments (not held for long-term purposes) 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. In some aspects, healthcare entities are charged for 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 market 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, 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. Classification of Revenues

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

Operating revenues - 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 - 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, such as investment income.

g. Deferred Outflows/Inflows of Resources

In addition to assets, GASB No. 63 requires the presentation of a separate financial statement element, deferred outflows of resources, which represents a consumption of net position that applies to future periods. The Research Foundation has no items that qualify for reporting in this category.

In addition to liabilities, GASB No. 63 requires the presentation of a separate financial statement element, deferred inflows of resources, which represents an acquisition of net

position that applies to future periods. The Research Foundation has no items that qualify for reporting in this category.

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, cooperative agreements, or contracts. 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 \$10.5 million at both June 30, 2013 and 2012, are recorded as a liability in the Research Foundation's financial statements as grant advances.

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 taxable 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 2012 amounts have been reclassified to conform to the 2013 presentation. These reclassifications had no effect on the change in net position.

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 Foundations' 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 custodial credit risk for deposits is the risk that, in the event of failure of the counterparty to a transaction, a government will not be able to recover the value of the deposits. The Research Foundation does not have a formal policy addressing custodial credit risk.

3. Transactions 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 \$10.5 million and

\$11.2 million for the years ended June 30, 2013 and 2012, respectively. Additional research support transfers to the University totaled \$0.1 million and \$0.4 million for the years ended June 30, 2013 and 2012, respectively.

The Research Foundation transferred \$3.3 million and \$6.1 million related to capital projects and debt service payments during the fiscal years ended June 30, 2013 and 2012, 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 the years ended June 30, 2013 and 2012, the Research Foundation was the recipient of \$2.4 million and \$3.0 million, respectively, from related entities to assist in funding cost share required by certain sponsored programs and grants.

Additionally, the Research Foundation received \$0.6 million and transferred \$0.7 million to related entities for the years ended June 30, 2013 and 2012, respectively.

4. Accounts Receivable, net

Accounts receivable, net as of June 30, 2013 and 2012, are summarized as follows (in thousands):

	2013		
	Gross		Net
	Receivable	Allowance	Receivable
Patient care	\$ 16,678	\$ (6,772)	\$ 9,906
Sponsored agreements	15,041	(2,740)	12,301
Other receivables	1,259	-	1,259
Total	<u>\$ 32,978</u>	<u>\$ (9,512)</u>	23,466
Current portion			22,307
Noncurrent portion			<u>\$ 1,159</u>
	2012		
	Gross		Net
	Receivable	Allowance	Receivable
Patient care	\$ 16,361	\$ (5,305)	\$ 11,056
Sponsored agreements	16,989	(2,588)	14,401
Total	<u>\$ 33,350</u>	<u>\$ (7,893)</u>	25,457
Current portion			24,972
Noncurrent portion			<u>\$ 485</u>

5. Capital Assets, net

Capital assets at historical cost as of June 30, 2013 and 2012 are summarized as follows (in thousands):

	2013				
	Beginning Balance	Additions	Retire- ments	Transfers (to)/ from Affiliates	Ending Balance
Cost - Non depreciable					
Construction in progress	\$ 3,476	\$ 963		\$ (2,300)	\$ 2,139
Subtotal	<u>3,476</u>	<u>963</u>		<u>(2,300)</u>	<u>2,139</u>
Cost - Depreciable					
Building	58,494	11		2,300	60,805
Land improvements	237	-		-	237
Equipment	74,868	3,333	\$ (1,245)	46	77,002
Leasehold improvements	702	-	-	-	702
Library materials	45	105	-	-	150
Subtotal	<u>134,346</u>	<u>3,449</u>	<u>(1,245)</u>	<u>2,346</u>	<u>138,896</u>
Total capital assets - cost	<u>137,822</u>	<u>4,412</u>	<u>(1,245)</u>	<u>46</u>	<u>141,035</u>
Accumulated depreciation					
Buildings	6,851	2,341	-	-	9,192
Land improvements	15	5	-	-	20
Equipment	52,657	7,132	(1,116)	4	58,677
Leasehold improvements	702	-	-	-	702
Library materials	30	9	-	-	39
Subtotal	<u>60,255</u>	<u>9,487</u>	<u>(1,116)</u>	<u>4</u>	<u>68,630</u>
Capital assets, net	<u>\$ 77,567</u>	<u>\$ (5,075)</u>	<u>\$ (129)</u>	<u>\$ 42</u>	<u>\$ 72,405</u>
2012					
	Beginning Balance	Additions	Retire- ments	Transfers (to)/ from Affiliates	Ending Balance
Cost - Non depreciable					
Construction in progress	\$ 1,481	\$ 2,175		\$ (180)	\$ 3,476
Subtotal	<u>1,481</u>	<u>2,175</u>		<u>(180)</u>	<u>3,476</u>
Cost - Depreciable					
Building	58,309	5		180	58,494
Land improvements	230	7		-	237
Equipment	67,893	7,467	\$ (492)	-	74,868
Leasehold improvements	702	-	-	-	702
Library materials	45	-	-	-	45
Subtotal	<u>127,179</u>	<u>7,479</u>	<u>(492)</u>	<u>180</u>	<u>134,346</u>
Total capital assets - cost	<u>128,660</u>	<u>9,654</u>	<u>(492)</u>	<u>-</u>	<u>137,822</u>
Accumulated depreciation					
Buildings	4,586	2,265	-	-	6,851
Land improvements	9	6	-	-	15
Equipment	45,657	7,466	(466)	-	52,657
Leasehold improvements	352	350	-	-	702
Library materials	26	4	-	-	30
Subtotal	<u>50,630</u>	<u>10,091</u>	<u>(466)</u>	<u>-</u>	<u>60,255</u>
Capital assets, net	<u>\$ 78,030</u>	<u>\$ (437)</u>	<u>\$ (26)</u>	<u>\$ -</u>	<u>\$ 77,567</u>

6. Other Liabilities

Other liabilities of the Research Foundation consisted of the following at June 30, 2013 and 2012 (in thousands):

	2013					
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retire-ments</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Other post-employment benefits	\$ 8,213	\$ 1,967	\$ (899)	\$ 9,281	\$ 1,302	\$ 7,979
Total	<u>\$ 8,213</u>	<u>\$ 1,967</u>	<u>\$ (899)</u>	<u>\$ 9,281</u>	<u>\$ 1,302</u>	<u>\$ 7,979</u>
	2012					
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retire-ments</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Other post-employment benefits	\$ 7,873	\$ 1,262	\$ (922)	\$ 8,213	\$ 1,460	\$ 6,753
Total	<u>\$ 7,873</u>	<u>\$ 1,262</u>	<u>\$ (922)</u>	<u>\$ 8,213</u>	<u>\$ 1,460</u>	<u>\$ 6,753</u>

The current portion of other post-employment benefits is included in accounts payable and accrued liabilities in the statements of net position as of June 30, 2013 and 2012.

7. Revenues From Clinical Services

a. Clinics and Laboratories

The University's School of Medicine operates various clinics, which generate revenues from the treatment of patients, as well as laboratory services. Revenues associated with the operations of these clinics totaled approximately \$41.9 million and \$57.7 million for the years ended June 30, 2013 and 2012, respectively.

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 faculty practice groups remit funds in two forms. The first portion, Academic Program Support, as defined in the Plan, is remitted directly to the Research Foundation to support the academic programs in the clinical departments. Academic Program Support remitted to the Research Foundation totaled approximately \$38.5 million and \$33.2 million for the years ended June 30, 2013 and 2012, respectively. The second portion, the Dean's Fund, as defined in the Plan, is collected by the University of Louisville Medical School Fund (Medical School Fund) from the 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 by the Medical School Fund totaled approximately \$3.0 million and \$3.6 million for the years ended June 30, 2013 and 2012, 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 will be a budget item annually determined and will take 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. Certain services continue to be provided by University Medical Center, Inc. (UMC). Funding from the affiliation agreements for the years ended June 30, 2013 and 2012 was approximately \$41.5 million and \$40.0 million, respectively. This agreement addresses the patient care needs of the Hospital's inpatients.

d. University of Louisville Physicians, Inc. (ULP)

During the fiscal year ended June 30, 2013, most existing practice groups became subsidiary entities to ULP, which was established to integrate the faculty practice arrangement for clinical services. In March 2013, ULP reached an agreement with the Medical School Practice Association (MSPA) doing business as University Physician Associates to acquire substantially all the assets of MSPA and assume the remaining liability to Passport. At the same time certain funding from the Medicaid HMO, Passport Health Plan (safety net funding) was transferred to ULP.

The Medical School Fund, UMC, ULP, and MSPA are legally distinct organizations with separate governing bodies. Their financial statements are not included with those of the Research Foundation.

e. 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 \$49.1 million and \$47.3 million for the years ended June 30, 2013 and 2012, respectively.

8. Expenses

Operating expenses by natural classification for the years ended June 30, 2013 and 2012 were approximately (in thousands):

	<u>2013</u>	<u>2012</u>
Salaries and wages	\$ 187,275	\$ 188,671
Employee benefits	44,496	44,328
Supplies and services	76,214	78,654
Depreciation	9,481	10,091
Scholarships and fellowships	40,991	41,424
	<u>\$ 358,457</u>	<u>\$ 363,168</u>

9. Retirement Plan

University personnel participate in a contributory retirement plan. The Research Foundation recorded expenses related to the defined contribution plan of approximately \$12.1 million and \$12.4 million during the years ended June 30, 2013 and 2012, respectively.

10. Postemployment Healthcare Benefits

a. Plan Description

University personnel are eligible for postemployment healthcare benefits as described in The University of Louisville Group Health Plan (Plan), administered by the University. 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.

Effective July 1, 2012, the life insurance benefit was restructured to be priced as a fully insured supplemental benefit for which the retirees pay 100% of the cost, so no obligation is assumed after the fiscal year ended June 30, 2012.

b. Funding Policy

The Plan is funded on a pay-as-you-go basis. During the years ended June 30, 2013 and 2012, the University contributed approximately \$1.0 million and \$0.8 million, approximately 56% and 50% of total premiums, respectively. Retired Plan members under age 65 receiving benefits contributed approximately \$0.8 million for each year, approximately 44% and 50% of total premiums for the years ended June 30, 2013 and 2012, respectively, through their required monthly contributions according to the schedules below:

	2013				
	Cardinal				
	<u>PPO</u>	<u>Care Plan</u>	<u>EPO</u>	<u>PCA High</u>	<u>PCA Low</u>
Employee	\$ 389	\$ 419	\$ 431	\$ 279	\$ 208
Employee and Spouse	\$ 763	\$ 828	\$ 850	\$ 583	\$ 451

	2012				
	Cardinal				
	<u>PPO</u>	<u>Care Plan</u>	<u>EPO</u>	<u>PCA High</u>	<u>PCA Low</u>
Employee	\$ 364	\$ 394	\$ 406	\$ 254	\$ 183
Employee and Spouse	\$ 738	\$ 803	\$ 825	\$ 558	\$ 426

Medicare-eligible retirees receive a monthly benefit of \$108 per individual covered. For each of the years ended June 30, 2013 and 2012, the University contributed \$1.2 million for Medicare-eligible retirees.

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

The University's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45 – *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB Statement No. 45). The ARC represents a level of funding that, if paid on an ongoing basis,

is projected to cover normal cost each year and amortize any unfunded actuarial accrued liabilities (AAL) over a period not to exceed thirty years.

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>2013</u>	<u>2012</u>
Normal cost	\$ 4,190	\$ 5,068
AAL amortization	4,693	4,313
Annual required contribution (ARC)	<u>8,883</u>	<u>9,381</u>
Interest on above	717	759
Adjustment to ARC	(880)	(886)
OPEB liability gain	<u>(3,244)</u>	<u>(5,917)</u>
Annual OPEB cost (AOC)	5,476	3,337
Contributions made	(2,221)	(2,025)
(Decrease)/increase in net OPEB obligation	<u>3,255</u>	<u>1,312</u>
Net OPEB obligation - beginning of year	24,045	22,733
Net OPEB obligation - end of year	<u><u>\$ 27,300</u></u>	<u><u>\$ 24,045</u></u>

The University's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation were as follows:

Fiscal Year Ended June 30,	Annual OPEB Cost/(Gain)	Percentage of Annual OPEB Cost/(Gain) Contributed	Net OPEB Obligation
2013	\$ 5,476	41%	\$ 27,300
2012	3,337	61%	\$ 24,045
2011	(6,087)	-27%	\$ 22,733

The University allocates a portion of the AOC, and the corresponding OPEB obligation, to its affiliated corporations, including the Research Foundation. For the years ended June 30, 2013 and 2012, the Research Foundation's portion of the AOC was \$2.0 million and \$1.3 million, respectively. The Research Foundation's net OPEB obligation for the years ended June 30, 2013 and 2012 was \$9.3 million and \$8.2 million, of which \$8.0 million and \$6.8 million was recorded in other long term liabilities and \$1.3 million and \$1.4 million was recorded in accounts payable and accrued liabilities as of June 30, 2013 and 2012, respectively.

d. Funded Status and Funding Progress

As of July 1, 2012, the most recent actuarial valuation date, the plan was 0% funded. The actuarial accrued liability for benefits was \$82.3 million and \$79.9 million and there were no assets, resulting in an unfunded actuarial accrued liability (UAAL) of \$82.3 million and \$79.9 million as of June 30, 2013 and 2012, respectively. The covered payroll (annual

payroll of active employees covered by the Plan) was \$426.8 million and \$416.0 million, and the ratio of the UAAL to the covered payroll was 19%, for each of the years ended June 30, 2013 and 2012.

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 and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liabilities for benefits.

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 July 1, 2012, actuarial valuation, the unit credit method actuarial cost method was used. The actuarial assumptions included a 3 percent investment rate of return (net of administrative expenses), which is based on the estimated return on the University's general assets, and an annual healthcare cost trend rate of 9 percent initially, reduced by decrements to an ultimate rate of 5 percent after 8 years. The gains on the benefit obligation recognized during the fiscal years ended June 30, 2013 and 2012 were due to updates made on expected future health claims and changes made to the retiree life insurance benefit. Expected claims have decreased based on a review of actual claims over the last three years as well as current COBRA rates. The UAAL is being amortized on a straight line basis over 30 years. The remaining amortization period at June 30, 2013 was 24 years.

11. Restatement of Prior Years' Financial Statements

The Research Foundation's audited financial statements for June 30, 2012, issued on October 3, 2012 have been restated to properly reflect amounts payable to third parties previously included in revenue. The net effect of this misstatement was to reclassify amounts from net position to accounts payable and accrued expenses as of July 1, 2011.

The following financial statement line items for 2012 were affected by this correction:

	<u>As Previously Reported</u>	<u>Adjustment for Restatement</u>	<u>As Restated</u>
<i>Statements of Net Position</i>			
Accounts payable and accrued liabilities	\$12,471	\$4,541	\$17,012
Current liabilities	22,952	4,541	27,493
Total liabilities	29,705	4,541	34,246
Unrestricted net position	31,098	(4,541)	26,557
Total net position	113,316	(4,541)	108,775
<i>Statements of Revenues, Expenses and Changes in Net Position</i>			
Net position - end of year	113,316	(4,541)	108,775

12. Commitments and Contingencies

a. Commitments

At June 30, 2013 and 2012, respectively, the Research Foundation had approximately \$11.4 million and \$16.7 million in encumbrances outstanding 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.

13. Recent Accounting Pronouncements

In April 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement clarifies the appropriate reporting of deferred outflows and deferred inflows of resources to ensure consistency in financial reporting. Accounting changes to comply with the standard will be applied retroactively by restating financial statements for all periods presented. The adoption of GASB No. 65 will require classification of certain items and a change in the recognition of certain items previously reported as assets and liabilities, beginning with the fiscal year ending June 30, 2014.

GASB has issued additional standards, Statement No. 66, *Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62*; Statement No. 67, *Financial Reporting for Pension Plans – An Amendment of GASB Statement No. 25*; Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*; Statement No. 69, *Government Combinations and Disposals of Government Operations*; and Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The Research Foundation does not believe these standards will impact the financial statements.

REQUIRED SUPPLEMENTARY INFORMATION
Schedule of Funding Progress by the University
For Other Postemployment Benefits
(in thousands)

Actuarial Value Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a) / c)
7/1/2012	-	\$ 82,260	\$ 82,260	0%	\$ 426,752	19%
7/1/2011	-	\$ 79,912	\$ 79,912	0%	\$ 416,016	19%
7/1/2010	-	\$ 79,892	\$ 79,892	0%	\$ 400,911	20%