

UNIVERSITY OF LOUISVILLE RESEARCH FOUNDATION, INC.

A Component Unit of the University of Louisville

**Auditor's Report and Financial Statements
June 30, 2017 and 2016**

UNIVERSITY OF LOUISVILLE RESEARCH FOUNDATION, INC.

A Component Unit of the University of Louisville

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INDEPENDENT AUDITOR'S 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 University of Louisville Research Foundation, Inc. (Research Foundation), a component unit of the University of Louisville, as of and for the years ended June 30, 2017 and 2016, 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.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2017 and 2016, and the changes in its financial position and its cash flows thereof for the years 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 30, to be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by 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.

Crowe Horwath LLP
Crowe Horwath LLP

Louisville, Kentucky
October 19, 2017

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, 2017, 2016, and 2015. 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 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, 2017, total awards were \$147.8 million, an increase of \$13.2 million or 9.8%, as compared to fiscal year 2016. Some of the funding highlights include:

- \$4.1 million from the Ky. Counsel on Postsecondary Ed. for Tobacco Tax Funding-Cancer Research
- \$3.9 million from Regenerex for FCRx Manufacturing and R & D
- \$3.7 million from the Ky. Counsel on Postsecondary Ed. for the Kentucky Lung Cancer Research Program
- \$3.6 million from the National Institutes of Health (NIH) for Kentucky IDeA Networks of Biomedical Research Excellence

The Research Foundation faculty continued to receive national recognition. Doctor Aruni Bhatnagar was named Research Exemplar in Biomedical Sector. Dr. Bhatnagar is a leading environmental health scientist who led the creation of the field of environmental cardiology. Through multidisciplinary approaches, he has identified the influence of environmental factors that contribute to systemic inflammation and cardiovascular disease risk. His work has extended from basic bench research to national and global policy.

Financial Highlights

- The Research Foundation's financial position remains strong at June 30, 2017, with total assets of \$105.9 million and liabilities of \$56.0 million as compared to June 30, 2016 at \$116.5 million of total assets and \$54.5 million of liabilities. Net position, which represent the residual interest in the Research Foundation's assets after liabilities are deducted, was \$49.8 million and \$62.0 million for the years ended June 30, 2017 and 2016, respectively.
- The Research Foundation's total liabilities of \$56.0 million contain grant advances. Grant advances represent the unearned portion of grants and sponsored programs and comprise \$2.6 million or 4.7% of total liabilities.

- Operating revenues amounted to \$363.1 million and \$365.6 million and operating expenditures were \$415.6 million and \$409.6 million resulting in a net operating loss of \$52.5 million and \$44.0 million for the years ended June 30, 2017 and 2016, respectively. When adjusted for net nonoperating revenues of \$40.4 million and \$33.2 million, net position of the Research Foundation decreased by \$12.1 million and \$10.8 million for the years ended June 30, 2017, and 2016, respectively.

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 \$44.6 million and \$43.4 million in nonexchange grants and contract revenue for the years ended June 30, 2017 and 2016, 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 \$2.6 million and \$2.0 million as of June 30, 2017 and 2016, respectively.
- Capital assets are depreciated and reported net of accumulated depreciation. The Research Foundation's capital assets as of June 30, 2017 and 2016 consist primarily of buildings, equipment and library materials with a net position value of \$61.7 million and \$66.0 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 Research Foundation accumulated or consumed resources 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, 2017, 2016, and 2015 is summarized on the following page:

Condensed Statements of Net Position
June 30, 2017, 2016, and 2015
(In Thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2017 - 2016</u> Change	<u>2016 - 2015</u> Change
ASSETS					
Current assets	\$ 37,763	\$ 49,750	\$ 41,899	\$ (11,987)	\$ 7,851
Capital assets	61,726	65,989	70,132	(4,263)	(4,143)
Other noncurrent assets	6,374	719	735	5,655	(16)
Total assets	<u>105,863</u>	<u>116,458</u>	<u>112,766</u>	<u>(10,595)</u>	<u>3,692</u>
LIABILITIES					
Current liabilities	40,527	41,822	28,926	(1,295)	12,896
Noncurrent liabilities	15,514	12,684	11,120	2,830	1,564
Total liabilities	<u>56,041</u>	<u>54,506</u>	<u>40,046</u>	<u>1,535</u>	<u>14,460</u>
NET POSITION					
Net investment in capital assets	61,726	65,989	70,132	(4,263)	(4,143)
Restricted - expendable	24,465	21,791	7,490	2,674	14,301
Unrestricted	(36,369)	(25,828)	(4,902)	(10,541)	(20,926)
Total net position	<u>\$ 49,822</u>	<u>\$ 61,952</u>	<u>\$ 72,720</u>	<u>\$ (12,130)</u>	<u>\$ (10,768)</u>

Assets

A review of the Research Foundation's statement of net position at June 30, 2017 indicates that the Research Foundation is liquid with nearly \$37.8 million in current assets. Of the \$37.8 million in current assets, \$36.7 million, or 97%, consists of accounts receivable that are to be collected within the next year.

Noncurrent assets consist mainly of \$61.7 million of capital assets, which decreased due to \$7.1 million in depreciation offset by additional capital assets of \$2.9 million.

Liabilities

The Research Foundation's current liabilities consist of amounts due to the University of \$21.9 million for funding of operational expenses. This amount decreased \$4.7 million from the prior year. Additionally, current liabilities include \$2.6 million of unexpended cash advances for sponsored research activities, an increase of \$.7 million compared to June 30, 2016. 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 \$16.0 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 \$17.2 million, with the \$1.7 million current portion included in accounts payable and accrued expenses and the remainder shown as other long-term liabilities.

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, 2017 and 2016 was \$49.8 million and \$62.0 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

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 \$4.3 million from 2016. This decrease reflects \$7.1 million of depreciation and additions of \$2.9 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, 2017. The amounts remain restricted until the contract is completed.

Restricted expendable net position increased \$2.7 million, or 12%. The overall increase is due mainly to an increase in nongovernmental grants.

Unrestricted net position

Unrestricted net position decreased by \$10.5 million. The decrease in unrestricted net position results primarily from actual operating expenses exceeding clinical services and fixed contract revenues.

Fiscal Year 2016

The Research Foundation's financial position as of the fiscal year ended June 30, 2016 shows an increase in assets and an increase in liabilities with an overall decrease in net position. Assets increased during the fiscal year ended June 30, 2016 by \$3.7 million, or 3%, as compared to the fiscal year ended June 30, 2015. This increase was due mainly to the \$7.9 million increase in current accounts receivable and \$4.1 million decrease in capital assets. The increase in liabilities mainly resulted from the increase in amount due to the University, which increased \$20.6 million from the fiscal year ended June 30, 2015.

Net position decreased \$10.8 million, or 14.8%, compared to net position at June 30, 2015 due mainly to the \$20.9 million decrease in unrestricted net position for operating expenses exceeding revenues.

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, 2017, 2016, and 2015 is shown on the following page:

Condensed Statements of Revenues, Expenses and Changes in Net Position
Years ended June 30, 2017, 2016, and 2015
(In Thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2017 - 2016</u> <u>Change</u>	<u>2016 - 2015</u> <u>Change</u>
OPERATING REVENUES					
Clinical services	\$ 245,135	\$ 233,981	\$ 222,445	\$ 11,154	\$ 11,536
Grants and contracts	89,728	103,121	89,924	(13,393)	13,197
Facilities and administrative cost recoveries	25,064	24,611	22,596	453	2,015
Other operating revenues	3,214	3,897	2,160	(683)	1,737
Total operating revenues	<u>363,141</u>	<u>365,610</u>	<u>337,125</u>	<u>(2,469)</u>	<u>28,485</u>
OPERATING EXPENSES					
Depreciation	7,072	7,914	8,470	(842)	(556)
Other operating expenses	408,596	401,675	388,139	6,921	13,536
Total operating expenses	<u>415,668</u>	<u>409,589</u>	<u>396,609</u>	<u>6,079</u>	<u>12,980</u>
Operating loss	<u>(52,527)</u>	<u>(43,979)</u>	<u>(59,484)</u>	<u>(8,548)</u>	<u>15,505</u>
NONOPERATING REVENUES (EXPENSES)					
Nonexchange grants and contracts	44,629	43,417	43,313	1,212	104
Other nonoperating revenues	(4,232)	(7,118)	11,108	2,886	(18,226)
Total nonoperating revenues	<u>40,397</u>	<u>33,211</u>	<u>54,421</u>	<u>7,186</u>	<u>(21,210)</u>
Decrease in net position	<u>(12,130)</u>	<u>(10,768)</u>	<u>(5,063)</u>	<u>(1,362)</u>	<u>(5,705)</u>
NET POSITION					
Net position, beginning of year	61,952	72,720	77,783	(10,768)	(5,063)
Net position, end of year	<u>\$ 49,822</u>	<u>\$ 61,952</u>	<u>\$ 72,720</u>	<u>\$ (12,130)</u>	<u>\$ (10,768)</u>

Operating Revenues

The Research Foundation recognized \$363.1 million in operating revenues for the year ended June 30, 2017. This represents a minimal decrease in revenues from the \$365.6 million reported for the year ended June 30, 2016.

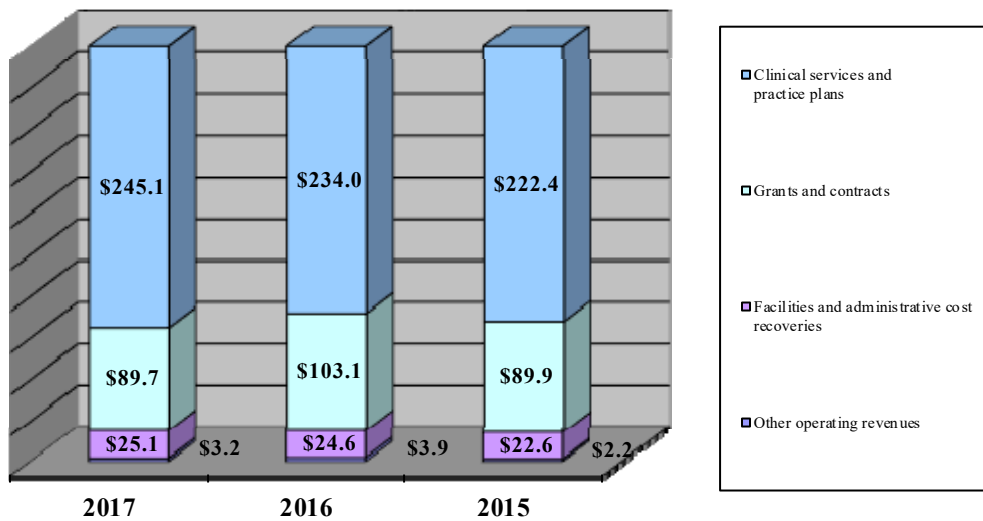
Revenues from clinical services were \$245.1 million for the year ended June 30, 2017. This is an increase of approximately \$11.1 million, or 5%, compared to \$234.0 million in similar revenues reported for the year ended June 30, 2016. The majority of the increase is attributed to increases in Medicaid related patient and intergovernmental transfers.

Revenues from grants and contracts were \$89.7 million for the year ended June 30, 2017 as compared to \$103.1 million in revenues reported in the previous year. This includes a decrease of \$12.1 million in nongovernmental grants and contracts and a decrease of \$1.5 million in federal grants and contracts. The decrease was partially offset by a \$0.1 million increase in state and local grants for the year ended June 30, 2017, as compared to the previous year.

Revenue from facilities and administrative cost recoveries were \$25.1 million and \$24.6 million for the years ended June 30, 2017 and 2016, 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, 2017 and 2016, approximately \$10.9 million and \$10.0 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, 2017, 2016, and 2015 (in millions).

Operating Revenues
Years Ended June 30, 2017, 2016, and 2015

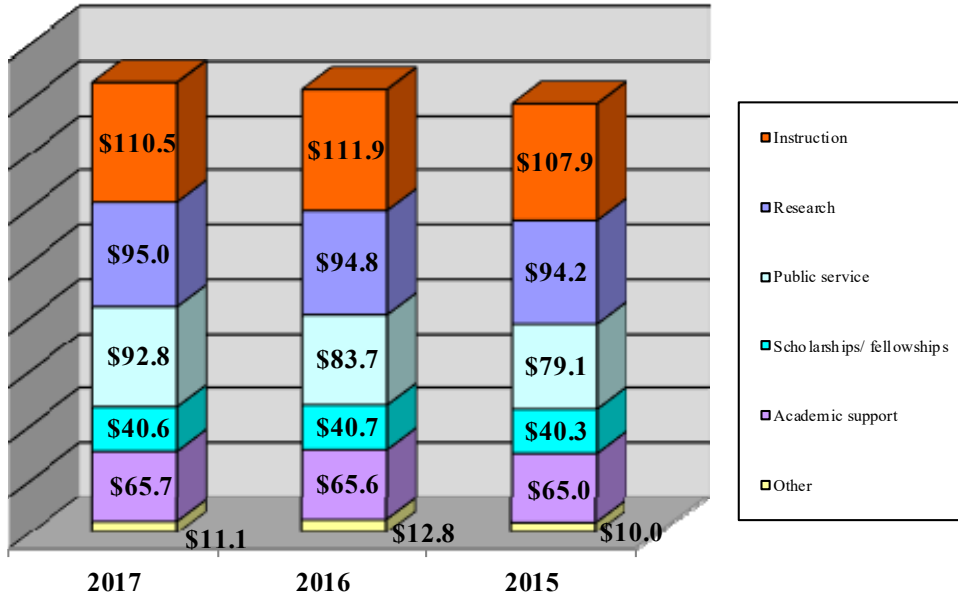


Operating Expenses by Functional and Natural Class

Total operating expenses were \$415.7 million and \$409.6 million for the fiscal years ended June 30, 2017 and 2016, respectively. The primary reason for the increase of \$6.1 million, or 1%, is an increase of \$5.6 million in salary expense as shown in the operating expenses by natural classification chart on the following page. Expenses in functional classification for instruction, research and public service all increased due to the increases in salaries.

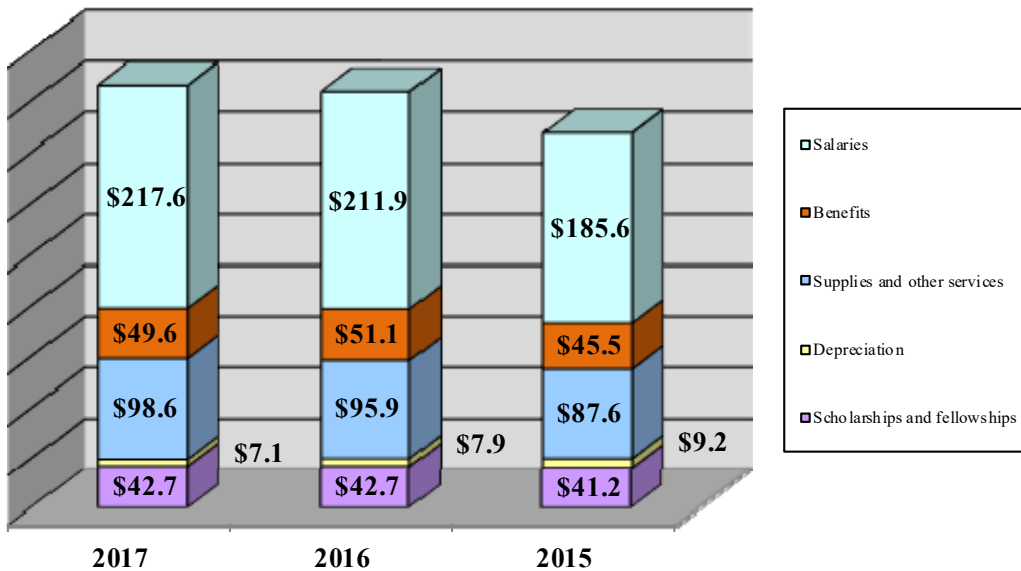
The following is a graphic illustration of total operating expenses by function for the years ended June 30, 2017, 2016 and 2015 (in millions):

**Operating Expenses by Functional Classification
Years ended June 30, 2017, 2016, and 2015**



The following is a graphic illustration of total operating expenses by natural classification for the years ended June 30, 2017, 2016 and 2015 (in millions):

**Operating Expenses by Natural Classification
Years ended June 30, 2017, 2016, and 2015**



Nonoperating Revenues (Expenses)

The Research Foundation's total nonoperating revenues of \$40.4 million for fiscal year ended June 30, 2017, was mostly comprised of nonexchange grants and contract revenues of \$44.6 million and transfer expenses of \$(7.1) million. Total nonoperating revenues increased by \$7.2 million as compared to fiscal year ended June 30, 2016. The increase is attributed to an increase in other nonoperating income of \$1.7 million, an increase in nonexchange grants and contracts of \$1.2 million and a reduction of contributions to related entities of \$4.2 million in fiscal year ending June 30, 2017.

Fiscal Year 2016

For the year ended June 30, 2016, Research Foundation reported \$365.6 million in operating revenues, an increase of 8% compared to the \$337.1 million reported for the year ended June 30, 2015.

Revenues from clinical services were \$234.0 million for fiscal year 2016, an increase of 5% from the fiscal year ended June 30, 2015. The majority of the increase is attributed to increases in Medicaid related patient and intergovernmental transfers.

Revenue from facilities and administrative cost recoveries were \$24.6 million and \$22.6 million for the years ended June 30, 2016 and 2015, respectively. The Research Foundation transferred approximately \$10.0 million and \$9.0 million during the years ended June 30, 2016 and 2015, respectively, in recognition of indirect support provided by the University.

Total operating expenses were \$409.6 million and \$396.6 million for the fiscal years ended June 30, 2016 and 2015, respectively. The increase of \$13.0 million, or 3%, was an increase in salary expense in the operating expenses by natural classification.

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, 2017, 2016, and 2015, are summarized on the following page:

Condensed Statements of Cash Flows
Years ended June 30, 2017, 2016, and 2015
(In Thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2017 - 2016</u> <u>Change</u>	<u>2016 - 2015</u> <u>Change</u>
Cash (used)/provided by:					
Operating activities	\$ (26,890)	\$ (49,994)	\$ (47,088)	\$ 23,104	\$ (2,906)
Noncapital and related financing activities	29,710	53,750	50,527	(24,040)	3,223
Capital financing activities	(2,877)	(3,809)	(4,247)	932	438
Investing activities	57	53	808	4	(755)
Net decrease in cash	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Cash and cash equivalents, beginning of year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
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 \$26.9 million of cash during the fiscal year ended June 30, 2017, representing a decrease of \$23.1 million compared to the prior year. While overall operating activities experienced a decrease in cash activities, the most significant were the decrease in cash outflow from payments for suppliers of \$2.2 million and the increase in cash inflow for clinical services of \$11.8 million from operations during the fiscal year ended June 30, 2017.

Other Activities

The \$29.7 million cash provided by noncapital and related financing activities relates mainly to the \$44.6 million provided by nonexchange grants and contracts and offset by a decrease in due to the University of \$10.6 million. It also includes the Research Foundation's transfer of \$7.1 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 decreased \$24.0 million from the fiscal year ended June 30, 2016.

Cash used for capital financing activities decreased \$0.9 million to \$2.9 million during the fiscal year ended June 30, 2017, due to a decrease in capital assets purchased.

Fiscal Year 2016

The Research Foundation operating activities used approximately \$50.0 million of cash during the fiscal year ended June 30, 2016, representing an increase of \$2.9 million compared to the prior year. While all categories of operating activities experienced an increase in cash activities the most significant were the increase in cash inflow from grants and contracts of \$6.9 million and the increase in cash outflow for payments to employees of \$10.1 million from operations during the fiscal year ended June 30, 2016.

The \$53.8 million cash provided by noncapital and related financing activities relates mainly to the \$43.4 million provided by nonexchange grants and contracts and an increase in funding from the University of \$20.6 million. It also includes the Research Foundation's transfer of \$10.0 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 \$3.2 million from the fiscal year ended June 30, 2015.

Economic Factors that May Affect the Future

The University is committed to achieving preeminence as a nationally recognized metropolitan research university. 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:

- At the national level, moderate growth in gross domestic product and a relatively improved unemployment picture suggest a stable near-term economic outlook for the country. However, proposed decreases in funding to the National Institutes of Health, which funds many research projects across the country including at UofL, and the amount of overhead that universities can recover for supporting federally-funded research, could have a negative impact on UofL if approved. The University continues to monitor the situation.
- The economic outlook for the Commonwealth of Kentucky is mixed. Personal income could grow 4.4 percent in FY 2018 compared to an expected 4.2 percent for the nation. Employment, though, continues to lag the country following the Great Recession. While national unemployment rates have dropped below 4.5 percent after peaking at 10 percent in 2009, Kentucky's unemployment rate was 5.1 percent in June 2017.
- The state ended FY 2017 with a \$138 million revenue shortfall. Although the state balanced its books using a variety of short-term mechanisms, uncertainty exists about state finances for FY 2018 and beyond. In order to avoid further reductions in spending, state revenues will have to increase at a higher-than-anticipated pace. Persistent pressure to increase funding to the state's public pension system—which remains one of the lowest funded in the nation—could affect state appropriations to public universities, even if revenues increase. The University does not participate in these pension plans and is subject only to indirect effects of their funding shortfall.
- To help reduce the state's pension liability, Governor Matt Bevin has expressed a strong desire to modernize the state's tax code and increase tax revenues. Expected legislative action could occur as early as this fall. Approved changes could influence the development of the state's 2018-2020 biennial budget. The legislature must adopt a biennial budget by April 2018.
- Relatedly, a performance-funding model for public universities and colleges, first implemented in FY 2017, remains in place. Under existing statute, FY 2019 is a hold-harmless year; public universities and colleges will not lose state funds based on performance. In FY 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 the other universities.
- Despite continued funding challenges at both the state and federal levels, the University has made significant progress in meeting its 2020 goals. Student enrollment remains steady. Demand, as measured by student applications, is strong.

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, 2017 and 2016
(In Thousands)

	<u>2017</u>	<u>2016</u>
ASSETS		
Current Assets:		
Accounts receivable, net	\$ 36,730	\$ 49,049
Due from Affiliate	296	-
Inventories	455	395
Other assets	282	306
Total current assets	<u>37,763</u>	<u>49,750</u>
Noncurrent Assets:		
Accounts receivable, net	742	717
Other long-term assets	2	2
Due from Affiliate	5,630	-
Capital assets, net	61,726	65,989
Total noncurrent assets	<u>68,100</u>	<u>66,708</u>
Total assets	<u>105,863</u>	<u>116,458</u>
LIABILITIES		
Current Liabilities:		
Accounts payable and accrued liabilities	16,014	13,275
Due to University of Louisville	21,904	26,610
Grant advances	2,609	1,937
Total current liabilities	<u>40,527</u>	<u>41,822</u>
Noncurrent Liabilities:		
Other long-term liabilities	15,514	12,684
Total noncurrent liabilities	<u>15,514</u>	<u>12,684</u>
Total liabilities	<u>56,041</u>	<u>54,506</u>
NET POSITION		
Net investment in capital assets	61,726	65,989
Restricted - expendable for:		
Research	16,799	14,888
Instruction	7	223
Public service	3,981	5,669
Scholarships and fellowships	3	-
Academic support	6	6
Institutional Support	3,669	1,005
Unrestricted	(36,369)	(25,828)
Total net position	<u>\$ 49,822</u>	<u>\$ 61,952</u>

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, 2017 and 2016
(In Thousands)

	<u>2017</u>	<u>2016</u>
OPERATING REVENUES		
Clinical services, net of contractual allowances of \$93,200 in 2017 and \$88,870 in 2016	\$ 245,135	\$ 233,981
Federal grants and contracts	68,161	69,613
State and local grants and contracts	8,881	8,734
Nongovernmental grants and contracts	12,686	24,774
Other operating revenue	3,214	3,897
Facilities and administrative cost recoveries	25,064	24,611
Total operating revenues	<u>363,141</u>	<u>365,610</u>
OPERATING EXPENSES		
Instruction	110,507	111,859
Research	94,950	94,815
Public service	92,794	83,701
Scholarships and fellowships	40,553	40,739
Academic support	65,717	65,583
Institutional support	3,598	4,897
Operation and maintenance of plant	464	67
Depreciation	7,072	7,914
Student services	8	9
Service centers	5	5
Total operating expenses	<u>415,668</u>	<u>409,589</u>
Operating loss	<u>(52,527)</u>	<u>(43,979)</u>
NONOPERATING REVENUES (EXPENSES)		
Gifts	886	1,491
Nonexchange grants and contracts	44,629	43,417
Investment income	8	10
Net realized and unrealized gain on investments	57	53
Other nonoperating income	1,902	161
Net nonoperating revenues	<u>47,482</u>	<u>45,132</u>
Contributions to related entities	(4,594)	(8,833)
Contributions to Affiliate	(2,491)	(3,088)
Total other revenues	<u>40,397</u>	<u>33,211</u>
Decrease in net position	(12,130)	(10,768)
NET POSITION		
Net position - beginning of year	61,952	72,720
Net position - end of year	<u>\$ 49,822</u>	<u>\$ 61,952</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, 2017 and 2016
(In Thousands)

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Clinical services	\$ 240,755	\$ 228,962
Grants and contracts	101,386	93,990
Facilities and administrative cost recoveries	25,064	24,611
Other operating revenue	3,212	4,234
Payments to employees	(212,169)	(211,528)
Payments for benefits	(46,774)	(49,644)
Payments for scholarships and fellowships	(42,707)	(42,716)
Payments to suppliers	(95,657)	(97,903)
Net cash used by operating activities	(26,890)	(49,994)
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES		
Contributions to/from related entities	(7,085)	(11,921)
Gifts	886	1,491
Nonexchange grants and contracts	44,628	43,417
Due to (due from) University of Louisville	(10,630)	20,595
Other noncapital financing activity	1,911	168
Net cash provided by noncapital and related financing activities	29,710	53,750
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchases of capital assets	(2,877)	(3,809)
Net cash used by capital and related financing activities	(2,877)	(3,809)
CASH FLOWS FROM INVESTING ACTIVITIES		
Sales of investments	57	53
Net cash provided by investing activities	57	53
Net decrease in cash and cash equivalents	-	-
Cash and cash equivalents - beginning of year	-	-
Cash and cash equivalents - end of year	-	-
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating loss	(52,527)	(43,979)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation	7,072	7,914
Loss on disposal of equipment	67	39
Changes in assets and liabilities:		
Accounts receivable, net	12,294	(7,944)
Inventories	(60)	(21)
Other assets	24	132
Accounts payable and accrued liabilities	2,739	(1,856)
Grant advances	673	(5,845)
Other long-term liabilities	2,828	1,566
Net cash used by operating activities	\$ (26,890)	\$ (49,994)

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, 2017 and 2016

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. 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 Managements Discussion and Analysis-For State and Local Governments*.

g. Deferred Inflows of Resources and Net Position

In addition to assets, GASB No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, 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, 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 \$2.6 million and \$1.9 million as of June 30, 2017 and 2016, 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 2016 amounts have been reclassified to conform to the 2017 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.

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 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

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 \$10.9 million and \$10.0 million for the years ended June 30, 2017 and 2016, respectively. Additional research support transfers to the University totaled \$6.2 million for the year ending June 30, 2017.

The Research Foundation transferred \$.5 million and \$5.2 million related to capital projects and debt service payments during the years ended June 30, 2017 and 2016, 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, 2017 and 2016, the Research Foundation was the recipient of \$6.3 million and \$5.0 million, respectively, from related entities to assist in funding cost share required by certain sponsored programs and grants.

Additionally, the Research Foundation transferred of \$0.3 million and received transfers of \$1.4 million from related entities for the years ended June 30, 2017 and 2016, respectively.

The Research Foundation transferred \$2.5 million and \$3.1 million for the years ended June 30, 2017 and 2016, respectively, to the PMOB, Inc. an affiliate entity, to fund shared construction cost of a pediatric building.

b. Receivables With Related Entities

In June 2016, 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 \$5.9 million as of June 2017.

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.

4. Accounts Receivable, net

Accounts receivable, net as of June 30, 2017 and 2016, are summarized as follows (in thousands):

	2017		Net Receivable
	Gross Receivable	Allowance	
Patient care	\$ 69,073	\$ (48,148)	\$ 20,925
Sponsored agreements	18,310	(1,763)	16,547
Total	<u>\$ 87,383</u>	<u>\$ (49,911)</u>	37,472
Current portion			36,730
Noncurrent portion			<u>\$ 742</u>

	2016		Net Receivable
	Gross Receivable	Allowance	
Patient care	\$ 72,045	\$ (42,072)	\$ 29,973
Sponsored agreements	22,533	(2,740)	19,793
Total	<u>\$ 94,578</u>	<u>\$ (44,812)</u>	49,766
Current portion			49,049
Noncurrent portion			<u>\$ 717</u>

5. Capital Assets, net

Capital assets at historical cost as of June 30, 2017 and 2016 are summarized as follows (in thousands):

	2017				
	Beginning Balance	Additions	Retire-ments	Transfers	Ending Balance
Cost - Non depreciable					
Land	\$ 352	\$ -	\$ -	\$ -	\$ 352
Construction in progress	\$ -	\$ -	\$ -	\$ -	-
Subtotal	352	-	-	-	352
Cost - Depreciable					
Building	70,727	-	-	-	70,727
Infrastructure	929	-	-	-	929
Land improvements	237	-	-	-	237
Equipment	84,493	2,877	(1,892)	-	85,478
Leasehold improvements	818	-	-	-	818
Library materials	44	-	-	-	44
Subtotal	157,248	2,877	(1,892)	-	158,233
Total capital assets - cost	157,600	2,877	(1,892)	-	158,585
Accumulated depreciation					
Buildings	17,231	2,877	-	-	20,107
Infrastructure	39	15	-	-	55
Land improvements	40	6	-	-	46
Equipment	73,547	4,167	(1,825)	-	75,888
Leasehold improvements	714	6	-	-	720
Library materials	40	2	-	-	41
Subtotal	91,611	7,072	(1,825)	-	96,859
Capital assets, net	\$ 65,989	\$ (4,195)	\$ (67)	\$ -	\$ 61,726

	2016				
	Beginning Balance	Additions	Retire-ments	Transfers (to)/ from Affiliates	Ending Balance
Cost - Non depreciable					
Land	\$ 352	\$ -	\$ -	\$ -	\$ 352
Construction in progress	-	-	-	-	-
Subtotal	352	-	-	-	352
Cost - Depreciable					
Building	70,727	-	-	-	70,727
Infrastructure	929	-	-	-	929
Land improvements	237	-	-	-	237
Equipment	82,525	3,809	(1,841)	-	84,493
Leasehold improvements	818	-	-	-	818
Library materials	44	-	-	-	44
Subtotal	155,280	3,809	(1,841)	-	157,248
Total capital assets - cost	155,632	3,809	(1,841)	-	157,600
Accumulated depreciation					
Buildings	14,357	2,874	-	-	17,231
Infrastructure	24	15	-	-	39
Land improvements	34	6	-	-	40
Equipment	70,340	5,009	(1,802)	-	73,547
Leasehold improvements	708	6	-	-	714
Library materials	37	3	-	-	40
Subtotal	85,500	7,913	(1,802)	-	91,611
Capital assets, net	\$ 70,132	\$ (4,104)	\$ (39)	\$ -	\$ 65,989

6. Other Liabilities

Other liabilities of the Research Foundation consisted of the following at June 30, 2017 and 2016 (in thousands):

	2017					
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retire-ments</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Other postemployment benefits	\$ 14,337	\$ 3,887	\$ (1,015)	\$ 17,209	\$ 1,695	\$ 15,514
Total	<u>\$ 14,337</u>	<u>\$ 3,887</u>	<u>\$ (1,015)</u>	<u>\$ 17,209</u>	<u>\$ 1,695</u>	<u>\$ 15,514</u>

	2016					
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retire-ments</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Other postemployment benefits	\$ 12,884	\$ 2,294	\$ (841)	\$ 14,337	\$ 1,653	\$ 12,684
Total	<u>\$ 12,884</u>	<u>\$ 2,294</u>	<u>\$ (841)</u>	<u>\$ 14,337</u>	<u>\$ 1,653</u>	<u>\$ 12,684</u>

The current portion of other postemployment benefits is included in accounts payable and accrued liabilities in the statements of net position as of June 30, 2017 and 2016.

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. Revenues associated with the operations of these clinics totaled approximately \$119.1 million and \$118.2 million for the years ended June 30, 2017 and 2016, 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 \$7.0 million and \$1.1 million for the years ended June 30, 2017 and 2016, 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. Starting in fiscal year 2017, the departments remit the Dean's Fund directly to the Research Foundation. Amounts

remitted to the Research Foundation by the Medical School Fund totaled approximately \$7.0 million and \$1.2 million for the years ended June 30, 2017 and 2016, 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 was be a budget item annually determined and took 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 continued to be provided by University Medical Center, Inc. (UMC). Funding from the affiliation agreements for the years ended June 30, 2017 and 2016 was approximately \$65.6 million and \$60.7 million, respectively. This agreement addresses the patient care needs of the Hospital's inpatients. The agreement ended June 30, 2017. Refer to Note 13 Subsequent Event for additional information.

d. Norton Healthcare

In December 17, 2015, Norton Healthcare, Inc., (Norton) and the University of Louisville and the Commonwealth of Kentucky agreed to a Settlement Agreement, 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. 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, 2017 and 2016 was \$20.0 million and \$35.0 million, respectively. The Settlement Agreement also included a payment of \$8.0 million, received in the year ending June 30, 2016, to the Research Foundation for expenses incurred.

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 \$33.4 million and \$17.6 million for the years ended June 30, 2017 and 2016, respectively.

8. Expenses

Operating expenses by natural classification for the years ended June 30, 2017 and 2016 were approximately (in thousands):

	<u>2017</u>	<u>2016</u>
Salaries and wages	\$ 217,599	\$ 211,954
Employee benefits	\$ 49,645	\$ 51,098
Supplies and services	\$ 98,645	\$ 95,908
Depreciation	\$ 7,072	\$ 7,914
Scholarships and fellowships	\$ 42,707	\$ 42,716
	<u>\$ 415,668</u>	<u>\$ 409,589</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 \$14.0 million and \$13.9 million during the years ended June 30, 2017 and 2016, respectively. As of June 30, 2017 and 2016, the Research Foundation had no outstanding liability related to the Retirement Plan.

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. 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.

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, 2017 and 2016, the University contributed approximately \$1.3 million and \$1.9 million, approximately 43% and 66% of total premiums, respectively. Retired Plan members under age 65 receiving benefits contributed approximately \$1.7 million and \$1.0 million, approximately 57% and 39% of total premiums for the years ended June 30, 2017 and 2016, respectively, through their required monthly contributions according to the schedules below:

2017					
	Cardinal				
	PPO	Care Plan	EPO	PCA High	PCA Low
Employee	\$ 335	N/A	\$ 353	\$ 281	\$ 248
Employee and Spouse	\$ 811	N/A	\$ 851	\$ 692	\$ 555
2016					
	Cardinal				
	PPO	Care Plan	EPO	PCA High	PCA Low
Employee	\$ 335	\$ 407	\$ 353	\$ 281	\$ 248
Employee and Spouse	\$ 811	\$ 871	\$ 851	\$ 692	\$ 555

Medicare-eligible retirees receive a monthly benefit of \$108 per individual covered. For the years ended June 30, 2017 and 2016, the University contributed \$1.7 million and \$1.6 million, respectively, 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):

	2017	2016
Normal cost	\$ 5,423	\$ 5,061
AAL amortization	5,673	5,252
Annual required contribution (ARC)	11,096	10,313
Interest on above	1,497	1,258
Adjustment to ARC	(2,246)	(1,825)
OPEB liability (gain)/loss	311	(3,566)
Annual OPEB cost (AOC)	10,658	6,181
Contributions made	(3,007)	(2,437)
Increase in net OPEB obligation	7,651	3,743
Net OPEB obligation - beginning of year	40,742	36,999
Net OPEB obligation - end of year	<u>\$ 48,393</u>	<u>\$ 40,742</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 (in-thousands):

<u>Fiscal Year Ended June 30,</u>	<u>Annual OPEB Cost/(Gain)</u>	<u>Percentage of Annual OPEB Cost/(Gain) Contributed</u>	<u>Net OPEB Obligation</u>
2017	\$ 10,658	28%	\$ 48,393
2016	\$ 6,180	39%	\$ 40,742
2015	\$ 9,125	35%	\$ 36,999
2014	\$ 6,817	45%	\$ 31,069

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, 2017 and 2016, the Research Foundation's portion of the AOC was \$3.9 million and \$2.3 million, respectively. The Research Foundation's net OPEB obligation for the years ended June 30, 2017 and 2016 was \$17.2 million and \$14.3 million, of which \$15.5 million and \$12.7 million was recorded in other long-term liabilities and \$1.7 million and \$1.7 million was recorded in accounts payable and accrued liabilities as of June 30, 2017 and 2016, respectively.

d. Funded Status and Funding Progress

As of July 1, 2016, the most recent actuarial valuation date, the plan was 0% funded. The actuarial accrued liability for benefits was \$95.5 million and \$89.7 million and there were no assets, resulting in an unfunded actuarial accrued liability (UAAL) of \$95.5 million and \$89.7 million as of June 30, 2017 and 2016, respectively. The covered payroll (annual payroll of active employees covered by the Plan) was \$499.0 million and \$478.2 million, and the ratio of the UAAL to the covered payroll was 19% for each of the years ended June 30, 2017 and 2016.

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 in time. 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, 2016, 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 8.3 percent initially, reduced by decrements to an ultimate rate of 4.5 percent after 11 years. The gains or losses on the benefit obligation recognized during the fiscal years ended June 30, 2017 and 2016 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, 2016 was 20 years.

11. Commitments and Contingencies

a. Commitments

At June 30, 2017 and 2016, respectively, the Research Foundation had approximately \$4.4 million and \$5.2 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. Recent Accounting Pronouncements

As of June 30, 2017, the following GASB statements were implemented which did not have a financial or disclosure impact on the financial statements.

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This statement improves the usefulness of information about post-employment benefits other than pensions and is applicable to plans that are administered through trusts.

GASB Statement No. 77, *Tax Abatement Disclosures*. This statement requires governments to provide additional disclosures about tax abatement agreements.

GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension plans*. This statement addresses a practice issue regarding the scope and applicability of

GASB Statement 68, *Accounting and Reporting for Pensions*, to certain multiple- employer defined benefit pension plans.

GASB Statement No. 80, *Blending Requirements for Certain Component Units-an amendment of GASB Statement No. 14*. This statement amends the blending requirement for certain component units incorporated as a not-for-profit corporation which the primary government is the sole corporate member.

GASB Statement No. 82, *Pension Issues– An Amendment of GASB Statements No. 67, No. 68 and No. 73*. This statement addresses certain issues that had been raised regarding the presentation of payroll-related measures in required supplementary information, the selection of assumptions and the classification of payments made by employers.

As of June 30, 2017, the GASB has issued the following statements that could be applicable to the University.

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The University has not yet adopted this standard and is evaluating the impact it may have on its financial statements.

GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. The University has not yet adopted this standard and is evaluating the impact it may have on its financial statements.

GASB Statement No. 83, *Certain Asset Retirement Obligations*. The University has not yet adopted this standard and is evaluating the impact it may have on its financial statements.

GASB Statement No. 84, *Fiduciary Activities*. The University has not yet adopted this standard and is evaluating the impact it may have on its financial statements.

GASB Statement No. 85, *Omnibus 2017*. The University has not yet adopted this standard and is evaluating the impact it may have on its financial statements.

GASB Statement No. 86, *Certain Debt Extinguishment Issues*. The University has not yet adopted this standard and is evaluating the impact it may have on its financial statements.

GASB Statement No. 87, *Leases*. The University has not yet adopted this standard and is evaluating the impact it may have on its financial statements.

13. Subsequent Event

Effective June 30, 2017, the academic affiliate agreement between the University and KentuckyOne and the joint operating agreement between University Medical Center, Inc. (UMC) and KentuckyOne were mutually terminated, ending KentuckyOne’s operational responsibilities for the University of Louisville Hospital (Hospital). As of the termination date, University Medical Center, Inc. (UMC) assumed operational responsibilities for the Hospital. The University has entered into an academic affiliate agreement with UMC that resumes the same level of funding for academic program support as they were stated in the agreement between the University and KentuckyOne.

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)
7/1/2016	-	\$ 95,461	\$ 95,461	0%	\$ 498,962	19%
7/1/2015	-	\$ 89,683	\$ 89,683	0%	\$ 478,201	19%
7/1/2014	-	\$ 89,098	\$ 89,098	0%	\$ 459,588	19%