**NEW ISSUE – Book-Entry-Only** **Ratings: See "RATINGS" herein**

*In the opinion of Bond Counsel for the Notes, based upon an analysis of laws, regulations, rulings and court decisions, and assuming continuing compliance with certain covenants made by the Commission, and subject to the conditions and limitations set forth herein under the caption "TAX TREATMENT" interest on the Notes is excludable from gross income for Federal income tax purposes and is not a specific item of tax preference for purposes of the Federal individual or corporate alternative minimum taxes. Interest on the Notes is exempt from Kentucky income tax and the Notes are exempt from ad valorem taxation by the Commonwealth of Kentucky and any of its political subdivisions.*

# $107,540,000
# KENTUCKY ASSET/LIABILITY COMMISSION
## UNIVERSITY OF KENTUCKY GENERAL RECEIPTS PROJECT NOTES, 2005 SERIES A

**Dated**: Date of delivery **Due:** October 1, as shown below

The University of Kentucky General Receipts Project Notes, 2005 Series A (the "Notes"), will be issued only as fully registered notes, and when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Notes. Purchasers will not receive certificates representing their ownership interest in the Notes purchased. So long as DTC or its nominee is the registered owner of the Notes, payments of the principal of and interest due on the Notes will be made directly to DTC. The Notes will be issued in denominations of $5,000 or any integral multiples thereof. Principal of and interest on the Notes will be paid directly to DTC by U.S. Bank National Association having offices in Atlanta, Georgia, as Trustee and Paying Agent (the "Trustee" and "Paying Agent").

The Notes will bear interest payable on each April 1 and October 1, commencing on April 1, 2006. The Notes mature on the dates, in the principal amounts, bear interest at the rates per annum and have the prices as follows:

| Maturity (October 1) | Principal Amount | Interest Rate | Yield | Maturity (October 1) | Principal Amount | Interest Rate | Yield |
|---|---|---|---|---|---|---|---|
| 2009 | $4,395,000 | 3.300% | 3.350% | 2016 | $4,125,000 | 5.000% | 4.130%* |
| 2010 | 4,545,000 | 3.400 | 3.470 | 2017 | 6,180,000 | 4.250 | 4.270 |
| 2011 | 905,000 | 3.625 | 3.650 | 2018 | 6,450,000 | 4.350 | 4.370 |
| 2011 | 3,810,000 | 4.000 | 3.650 | 2019 | 6,740,000 | 4.400 | 4.410 |
| 2012 | 2,320,000 | 3.750 | 3.780 | 2020 | 7,045,000 | 4.450 | 4.450 |
| 2012 | 2,585,000 | 4.000 | 3.780 | 2021 | 7,365,000 | 4.450 | 4.490 |
| 2013 | 1,850,000 | 3.900 | 3.900 | 2022 | 7,700,000 | 4.500 | 4.530 |
| 2013 | 3,265,000 | 5.000 | 3.900 | 2023 | 8,075,000 | 5.000 | 4.360* |
| 2014 | 420,000 | 4.000 | 4.000 | 2024 | 1,085,000 | 4.500 | 4.540 |
| 2014 | 4,945,000 | 5.000 | 4.000 | 2024 | 7,405,000 | 5.000 | 4.380* |
| 2015 | 1,345,000 | 4.000 | 4.060 | 2025 | 2,215,000 | 4.500 | 4.560 |
| 2015 | 4,290,000 | 5.000 | 4.060 | 2025 | 6,700,000 | 5.000 | 4.410* |
| 2016 | 1,780,000 | 4.125 | 4.130 | | | | |

*Priced to October 1, 2015 optional redemption date

The Notes are subject to optional redemption prior to maturity, as set forth herein. See "THE NOTES – Optional Redemption" herein.

The Kentucky Asset/Liability Commission (the "Commission") is issuing the Notes pursuant to a Resolution of the Commission adopted October 17, 2005, to (i) pay certain expenditures in certain amounts in connection with the construction of the Patient Care Facility - Hospital for the benefit of the University of Kentucky (the "University"), (ii) pay the interest coming due on the Notes through and including October 1, 2007 and (iii) pay the costs of issuing the Notes. See "THE PROJECT" herein. The Notes are being issued pursuant to the Trust Indenture dated as of November 1, 2005 (the "Indenture") between the Commission and the Trustee. See "THE NOTES" herein.

The Notes and any interest due thereon are payable solely and only from a special fund created under the Indenture and defined therein as the Note Payment Fund (the "Note Payment Fund"), into which Financing Payments (as defined herein) received from the University are to be deposited. The Financing Payments arise under a Financing/Lease Agreement, dated as of November 1, 2005 (the "Financing Agreement"), among the Commission, the University and the Commonwealth of Kentucky Finance and Administration Cabinet (the "Cabinet"). The University has authorized and entered into a Trust Agreement dated as of November 1, 2005 (the "Trust Agreement"), under which it has pledged its General Receipts, as defined in the Trust Agreement, as security for the payment of Obligations, as defined in the Trust Agreement, issued thereunder. The Financing Agreement constitutes an Obligation within the meaning of the Trust Agreement. See "SECURITY FOR THE NOTES," "SUMMARY OF THE PRINCIPAL DOCUMENTS" and "EXHIBIT A – SUMMARY OF THE TRUST AGREEMENT" herein.

The scheduled payment of principal of and interest on the Notes, when due, will be guaranteed under a municipal bond new issue insurance policy to be issued concurrently with the delivery of the Notes by Financial Guaranty Insurance Company ("Bond Insurer"). See "BOND INSURANCE POLICY" herein.

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THE NOTES ARE SPECIAL AND LIMITED OBLIGATIONS OF THE COMMISSION. THE NOTES DO NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE COMMONWEALTH, OR A PLEDGE OF THE FULL FAITH AND CREDIT OR TAXING POWER OF THE COMMONWEALTH, BUT ARE PAYABLE SOLELY FROM AMOUNTS DEPOSITED IN CERTAIN FUNDS AND ACCOUNTS CREATED BY THE RESOLUTION AND FROM RENTAL INCOME DERIVED FROM A FINANCING AGREEMENT WITH THE UNIVERSITY.

The Notes are offered when, as and if issued and accepted by the Underwriter, subject to the approving legal opinion of Peck, Shaffer & Williams LLP, Covington, Kentucky, Bond Counsel. Certain legal matters will be passed on for the Underwriter by its counsel, Thompson Hine LLP, Cincinnati, Ohio. It is expected that delivery of the Notes will be made on or about November 8, 2005, through the facilities of DTC, against payment therefore.

*MORGAN STANLEY*

**J.J.B. Hilliard, W.L. Lyons, Inc.** **Morgan Keegan & Company, Inc.** **NatCity Investments, Inc.**
**JPMorgan** **Ross, Sinclaire & Associates, Inc.** **A.G. Edwards**
**Edward D. Jones & Co., L.P.** **First Kentucky Securities Corp.** **Seasongood & Mayer LLC**

Dated: October 27, 2005

This Official Statement does not constitute an offer to sell the Notes to any person, or the solicitation of an offer from any person to buy the Notes, in any jurisdiction where such offer or such solicitation of an offer to buy would be unlawful. The information set forth herein is provided by the Commonwealth of Kentucky from sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness and is not to be construed as a representation of the Underwriter. No dealer, salesman or any other person has been authorized to give any information or to make any representation, other than those contained in this Official Statement, in connection with the offering contained herein, and, if given or made, such information or representation must not be relied upon as having been authorized by the Commonwealth of Kentucky or the Underwriter. The information and expressions of opinion contained herein are subject to change without notice, and neither the delivery of this Official Statement nor the sale of any Notes shall, under any circumstances, create any implication that there has been no change in the matters described herein since the date hereof. The Official Statement is submitted in connection with the issuance of the Notes referred to herein and may not be reproduced or used, in whole or in part, for any other purpose.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION OR AUTHORITY, NOR HAS SUCH FEDERAL OR ANY STATE COMMISSION OR AUTHORITY PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITER MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH TEND TO STABILIZE OR MAINTAIN THE MARKET PRICE FOR THE NOTES ABOVE THE LEVELS WHICH WOULD OTHERWISE PREVAIL. SUCH ACTIVITIES, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

## KENTUCKY ASSET/LIABILITY COMMISSION

### COMMISSION MEMBERS

R. B. Rudolph, Jr.
Secretary of the Finance and Administration Cabinet, Chairman

Gregory D. Stumbo
Attorney General

Jonathan Miller
State Treasurer

Bradford L. Cowgill
State Budget Director

### SECRETARY TO THE COMMISSION

F. Thomas Howard
Executive Director of the Office of Financial Management

### UNIVERSITY OF KENTUCKY BOARD OF TRUSTEES



### TRUSTEE AND PAYING AGENT

U.S. Bank National Association
Having offices in Atlanta, Georgia

### BOND COUNSEL

Peck, Shaffer & Williams LLP
Covington, Kentucky

### UNDERWRITERS' COUNSEL

Thompson Hine LLP
Cincinnati, Ohio

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**SUMMARY**

The following information is furnished solely to provide limited introductory information regarding the Kentucky Asset/Liability Commission (the "Commission") and the Notes and does not purport to be comprehensive. Such information is qualified in its entirety by reference to the more detailed information and descriptions appearing elsewhere in this Official Statement and should be read together therewith. The terms used in this Summary and not otherwise defined shall have the respective meanings assigned to them elsewhere in this Official Statement. The offering of the Notes is made only by means of the entire Official Statement, including the Exhibits hereto. No person is authorized to make offers to sell, or solicit offers to buy, the Notes unless the entire Official Statement is delivered in connection therewith.

**The Commission** The Commission is an independent agency of the Commonwealth of Kentucky (the "Commonwealth"). See "THE KENTUCKY ASSET/LIABILITY COMMISSION" herein.

**The Offering** The Commission is offering its University of Kentucky General Receipts Project Notes, 2005 Series A in an aggregate principal amount of $107,540,000 (the "Notes"). See "THE NOTES" herein.

**Authority** The Notes are being issued pursuant to Section 56.860 *et seq*. of the Kentucky Revised Statutes (the "Act"), a Resolution adopted by the Commission on October 17, 2005 (the "Resolution"), and a Trust Indenture dated as of November 1, 2005 (the "Indenture"), between the Commission and U.S. Bank National Association having offices in Atlanta, Georgia, as trustee and paying agent (the "Trustee" and "Paying Agent"). The State Property and Buildings Commission of the Commonwealth also has approved the issuance of the Notes.

**Use of Proceeds** The proceeds of the Notes will be used by the Commission to (i) pay certain expenditures in certain amounts in connection with the construction of the Patient Care Facility - Hospital for the benefit of the University of Kentucky (the "University"), (ii) pay the interest coming due on the Notes through and including October 1, 2007 and (iii) pay the costs of issuing the Notes. See "THE PROJECT" herein.

**Features** The Notes will be dated as of the Date of Delivery, and will bear interest on each April 1 and October 1, commencing April 1, 2006, at the rates set forth on the cover page of this Official Statement and will mature on the dates set forth on the cover page of this Official Statement.

The Notes are subject to optional redemption prior to their respective maturities as described herein.

The Notes are issuable only as fully registered Notes, without coupons. The Notes are being offered in the authorized denominations of $5,000 or any integral multiples thereof, at the rates shown on the cover page hereof. The Notes, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Notes. Purchasers will not receive certificates representing their ownership interest in the Notes purchased. So long as DTC or its nominee is the registered owner of the Notes, payments of the principal of and interest due on the Notes will be made directly to DTC.

Principal of and interest on the Notes will be paid directly to DTC by the Trustee.

It is expected that delivery of the Notes will be made on or about November 8, 2005, through the facilities of DTC, against payment therefor.

**Security**

The Notes and the interest thereon are payable solely from payments of the Financing Payments (as defined herein) to be made by the University, as lessee of the Project, to the Commission, as lessor of the Project, under the Financing/Lease Agreement dated as of November 1, 2005 (the "Financing Agreement") among the Commission, the Commonwealth of Kentucky Finance and Administration Cabinet (the "Cabinet") and the University, and from the other sources described herein. The Commission has pledged to the payments of its obligations with respect to the Notes, the Financing Payments to be received from the University under the Financing Agreement. In addition, if the University fails to make timely payments under the Financing Agreement, the Secretary of the Cabinet is obligated, pursuant to KRS 164A.608, to apply to such payments, any funds that have been appropriated to the University that have not been disbursed. See "SECURITY FOR THE NOTES" and "SUMMARY OF THE PRINCIPAL DOCUMENTS" herein.

The University has authorized and entered into a Trust Agreement dated as of November 1, 2005 (the "Trust Agreement"), under which it has pledged its General Receipts, as defined in the Trust Agreement, as security for the payment of Obligations, as defined in the Trust Agreement, issued thereunder. The Financing Agreement constitutes an Obligation within the meaning of the Trust Agreement. The University's obligations under the Financing Agreement are, therefore, secured by a pledge of the University's General Receipts. See "SECURITY FOR THE NOTES" and "EXHIBIT A – SUMMARY OF THE TRUST AGREEMENT" herein.

THE NOTES ARE SPECIAL AND LIMITED OBLIGATIONS OF THE COMMISSION. THE NOTES DO NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE COMMONWEALTH, OR A PLEDGE OF THE FULL FAITH AND CREDIT OR TAXING POWER OF THE COMMONWEALTH, BUT ARE PAYABLE SOLELY FROM AMOUNTS DEPOSITED IN CERTAIN FUNDS AND ACCOUNTS CREATED BY THE RESOLUTION AND FROM RENTAL INCOME DERIVED FROM A FINANCING AGREEMENT WITH THE UNIVERSITY.

**Bond Insurance Policy**

The scheduled payment of principal of and interest on the Notes, when due, will be guaranteed under a municipal bond new issue insurance policy (the "Bond Insurance Policy") to be issued concurrently with the delivery of the Notes by Financial Guaranty Insurance Company.

| | |
|---|---|
| **Tax Status** | In the opinion of Bond Counsel for the Notes, based upon an analysis of existing laws, regulations, rulings and court decisions, interest on the Notes is excludable from gross income for Federal income tax purposes. Bond Counsel for the Notes is also of the opinion that interest on the Notes is not a specific item of tax preference under Section 57 of the Internal Revenue Code of 1986 (the "Code") for purposes of the Federal individual or corporate alternative minimum taxes. Furthermore, Bond Counsel for the Notes is of the opinion that interest on the Notes is exempt from income taxation by the Commonwealth and the Notes are exempt from ad valorem taxation by the Commonwealth and any of its political subdivisions. See "TAX TREATMENT" herein, and "EXHIBIT E." |
| **Continuing Disclosure** | Rule 15c2-12 under the Securities and Exchange Act of 1934, as amended, generally prohibits an underwriter from purchasing or selling municipal securities in an initial offering unless it has determined that the issuer of such securities has committed to provide annually, certain information, including audited financial information and notice of various events, if material, to enable the purchaser to comply with the provisions of Rule 15c2. |
| **General** | The Official Statement speaks only as of its date, and the information contained herein is subject to change. All summaries of documents and agreements in the Official Statement are qualified in their entirety by reference to such documents and agreements, copies of which are available from the Office of Financial Management. |
| **Information** | Information regarding the Notes is available by contacting the Office of Financial Management, 702 Capitol Avenue, Suite 76, Frankfort, Kentucky 40601 (502) 564-2924; or Office of the Treasurer, University of Kentucky, 301 Peterson Office Building, Lexington, Kentucky 40506 (859) 257-4758; or, during the initial offering period, the Underwriter, Morgan Stanley & Co. Incorporated, 2000 Westchester Avenue, Purchase, New York 10577 (914) 225-0203. |

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**OFFICIAL STATEMENT**

**$107,540,000**
**KENTUCKY ASSET/LIABILITY COMMISSION**
**UNIVERSITY OF KENTUCKY GENERAL RECEIPTS PROJECT NOTES, 2005 SERIES A**

## INTRODUCTION

This Official Statement (the "Official Statement"), which includes the cover page, is being distributed by the Kentucky Asset/Liability Commission (the "Commission"), an independent agency of the Commonwealth of Kentucky (the "Commonwealth"), to furnish pertinent information to the purchasers of $107,540,000 aggregate principal amount of its University of Kentucky General Receipts Project Notes, 2005 Series A (the "Notes"). The Notes are being issued pursuant to Section 56.860 *et seq*. of the Kentucky Revised Statutes (the "Act"), a Resolution adopted by the Commission on October 17, 2005 (the "Resolution"), and a Trust Indenture dated as of November 1, 2005 (the "Indenture"), between the Commission and U.S. Bank National Association having offices in Atlanta, Georgia, as trustee and paying agent (the "Trustee" and "Paying Agent").

The proceeds of the Notes will be used to (i) provide financing for the Project (as defined and described herein), (ii) pay the interest coming due on the Notes through and including October 1, 2007 and (iii) pay the costs of issuing the Notes. See "THE PROJECT" herein.

The Notes and the interest thereon are payable solely from payments of the Financing Payments (as defined herein) to be made by the University of Kentucky (the "University") to the Commission under the Financing/Lease Agreement dated as of November 1, 2005 (the "Financing Agreement") among the Commission, the Commonwealth of Kentucky Finance and Administration Cabinet (the "Cabinet") and the University. The Notes are also secured by certain other funds and accounts pledged therefor and described herein. In addition, if the University fails to make timely payments under the Financing Agreement, the Secretary of the Cabinet is obligated, pursuant to KRS 164A.608, to apply to such payments, any funds that have been appropriated to the University that have not been disbursed. See "SECURITY FOR THE NOTES" herein.

The University has authorized and entered into a Trust Agreement dated as of November 1, 2005 (the "Trust Agreement"), under which it has pledged its General Receipts, as defined in the Trust Agreement, as security for the payment of Obligations, as defined in the Trust Agreement, issued thereunder. The Financing Agreement constitutes an Obligation within the meaning of the Trust Agreement. The University's obligations under the Financing Agreement are, therefore, secured by a pledge of the University's General Receipts. See "SECURITY FOR THE NOTES" and "EXHIBIT A – SUMMARY OF THE TRUST AGREEMENT" herein.

The scheduled payment of the principal of and interest on the Notes, when due, will be guaranteed under a municipal bond new issue insurance policy (the "Bond Insurance Policy") to be issued concurrently with the delivery of the Notes by Financial Guaranty Insurance Company ("Bond Insurer"). See "BOND INSURANCE POLICY" herein.

The summaries and references to the Act, the Indenture, the Financing Agreement described herein, and the Notes included in this Official Statement do not purport to be comprehensive or definitive, and such summaries and references are qualified in their entirety by reference to each such document, copies of which are available for inspection at the Office of Financial Management, 702 Capitol Avenue, Suite 76, Frankfort, Kentucky 40601 (502) 564-2924; or Office of the Treasurer, University of Kentucky, 301 Peterson Office Building, Lexington, Kentucky 40506 (859) 257-4758; or, during the initial offering period, the Underwriter, Morgan Stanley & Co. Incorporated, 2000 Westchester Avenue, Purchase, New York 10577 (914) 225-0203, the underwriter of the Notes (the "Underwriter").

Capitalized terms used in this Official Statement and not otherwise defined will have the meanings given them under the caption "SUMMARY OF THE PRINCIPAL DOCUMENTS - Definitions" herein and in "EXHIBIT A – SUMMARY OF THE TRUST AGREEMENT."

## THE NOTES

### General

The Notes are issuable only as fully registered Notes. The Notes will be issuable in the denominations of $5,000 or any integral multiples thereof, will be dated as of the date of delivery, will bear interest payable on each April 1 and October 1, commencing April 1, 2006, at the rates set forth on the cover page of this Official Statement and will mature on the dates set forth on the cover page of this Official Statement. Principal of and interest on the Notes are payable in lawful money of the United States to the registered owner of the Notes, Cede & Co., as nominee of The Depository Trust Company ("DTC") in New York, New York, pursuant to the global book-entry system operated by DTC. See "EXHIBIT D – Book-Entry-Only System."

### Optional Redemption

The Notes maturing on or before October 1, 2015 are not subject to optional redemption prior to maturity. The Notes maturing after October 1, 2015 are subject to redemption at the option of the Commission on or after October 1, 2015, in whole or in part at any time, at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus accrued interest to the date fixed for redemption.

### Book-Entry-Only System

The Notes initially will be issued solely in book-entry form to be held in the book-entry-only system maintained by DTC. So long as such book-entry system is used, only DTC will receive or have the right to receive physical delivery of the Notes and, except as otherwise provided herein with respect to tenders by Beneficial Owners of Beneficial Ownership Interests, each as hereinafter defined, Beneficial Owners will not be or be considered to be, and will not have any rights as, owners or holders of the Notes under the Indenture. For additional information about DTC and the book-entry-only system see "EXHIBIT D – Book-Entry-Only System."

### Authorization

The Commission, at a meeting held on October 17, 2005, adopted the Resolution, which, among other things (i) authorized the Indenture, (ii) authorized and approved the issuance of the Notes, subject to approval by a representative of the Office of Financial Management ("OFM") acting as authorized officer of the Commission (the "Authorized Officer"), (iii) authorized the Financing Agreement and (iv) directed the preparation and distribution of this Official Statement.

The University, at a meeting held on September 20, 2005, adopted resolutions, which, among other things authorized (i) the Trust Agreement and (ii) the Financing Agreement.

The State Property and Buildings Commission of the Commonwealth also has approved the issuance of the Notes.

## SECURITY FOR THE NOTES

### General

The Notes and the interest thereon are payable solely from payments of the Financing Payments to be made by the University, as lessee of the Project, to the Commission, as lessor of the Project, under the Financing Agreement and from other sources described under this heading.

The University, as lessee, has entered into the Financing Agreement with the Commission and the Cabinet in order to provide the Commission, as lessor, with amounts to pay the principal of and interest on the Notes as they become due. The Commission has pledged to the payments of its obligations with respect to the Notes, the Financing Payments to be received from the University under the Financing Agreement. The University has pledged its General Receipts as security for its payment obligations under the Financing Agreement.

### Budgetary Process in the Commonwealth

The General Assembly is required by the Kentucky Constitution to adopt measures providing for the Commonwealth's revenues and appropriations for each fiscal year. The Governor is required by law to submit a biennial State Budget (the "State Budget") to the General Assembly during the legislative session held in each even numbered year. State Budgets have generally been adopted by the General Assembly during those legislative sessions, which end in mid-April, to be effective upon the Governor's signature for appropriations commencing for a two-year period beginning the following July 1.

In each of the last two even-numbered years, the regular legislative session of the General Assembly adjourned without adoption of a State Budget. On both occasions, the Governor signed Executive Orders authorizing the Secretary of the Finance and Administration Cabinet to issue warrants for the payment of all claims made by the Executive Branch of government in accordance with a Public Services Continuation Plan providing for the continued operation of state government in the absence of a legislatively adopted State Budget (the "Continuation Plan"). The Continuation Plans provided full spending authority for the total debt service payments. In both cases, the Kentucky General Assembly enacted a State Budget in March of the following odd numbered year, which incorporated the Continuation Plans and appropriated funds for the remainder of the biennium.

Although the University is required to submit its budgets to the General Assembly for approval as a part of the State Budget, the pledge of General Receipts by the University described herein is not subject to appropriation.

### Pledge of General Receipts

In the Financing Agreement, which is an "Obligation" under the Trust Agreement, the University has pledged its General Receipts as security for its payment obligations thereunder.

"General Receipts" means, as reported in the Financial Statements (having the designations, to the extent not otherwise defined in the Trust Agreement, set forth in the Financial Statements or such successor designations that may hereafter be used in Financial Statements):

(a) certain operating and non-operating revenues of the University, being (i) Student Registration Fees, (ii) nongovernmental grants and contracts, (iii) recoveries of facilities and administrative costs, (iv) sales and services, (v) Hospital Revenues, (vi) Housing and Dining Revenues, (vii) auxiliary enterprises – other auxiliaries, (viii) other operating revenues, (ix) state appropriations (for general operations), (x) gifts and grants, (xi) investment income, (xii) other nonoperating revenues and (xiii) other;

(b) but excluding (i) any receipts described in clause (a) which are contracts, grants, gifts, donations or pledges and receipts therefrom which, under restrictions imposed in such contracts, grants, gifts, donations or pledges, or, which as a condition of the receipt thereof or of amounts payable thereunder are not available for payment of Debt Service Charges, (ii) federal grants and contracts, (iii) state and local grants and contracts, (iv) federal appropriations, (v) county appropriations, (vi) professional clinical service fees, (vii) auxiliary enterprises – athletics; (viii) capital appropriations, (ix) capital grants and gifts, and (x) additions to permanent endowments, including research challenge trust funds;

provided, however, that General Receipts may

(c) include any other receipts that may be designated as General Receipts from time to time by a resolution of the board of the University delivered to the Trustee; and

(d) exclude any receipts not heretofore pledged, which may be designated from time to time by a resolution of the board of the University delivered to the Trustee;

(e) exclude any receipts heretofore pledged, which may be designated from time to time by a resolution of the board of the University delivered to the Trustee and each Rating Service then rating any Obligations, but only if each such Rating Service confirms in writing to the University that the exclusion of any such receipt would not cause a reduction or withdrawal of the then current rating on any Outstanding Obligations.

The University has outstanding, certain Consolidated Educational Buildings Revenue Bonds (the "Building Bonds") and certain Housing and Dining System Revenue Bonds (the "Housing Bonds"), to which General Receipts described in (a)(i) and (a)(vi) above are respectively pledged on a priority basis to the pledge of those General Receipts under the Trust Agreement. The University has covenanted not to issue any additional Building Bonds. The prior pledge of those General Receipts securing Building Bonds will terminate when there are no Building Bonds outstanding. See "EXHIBIT A" for information regarding outstanding Building Bonds. If Obligations are issued to pay the costs of housing and dining facilities ("Housing Facilities"), those Obligations must continue to be issued in compliance with the requirements of the trust indenture under which Housing Bonds have previously been issued (the "Housing Indenture"). The University has covenanted that it will provide, in any future proceedings relating to Obligations issued for Housing Facilities, that the covenant requiring such Housing Facilities to be a part of the Housing and Dining System created by the Housing Indenture (having revenues therefrom pledged on a priority basis to Housing Bonds) will terminate when there are no outstanding Housing Bonds that were outstanding as of the date of the Trust Agreement. The prior pledge of certain General Receipts securing Housing Bonds will terminate when there are no outstanding Housing Bonds that were outstanding as of the date of the Trust Agreement. See "EXHIBIT A" for information regarding outstanding Housing Bonds. There are currently no other Obligations outstanding under the Trust Agreement.

**State Intercept**

If the University fails to make timely payments under the Financing Agreement, the Secretary of the Cabinet is obligated, pursuant to KRS 164A.608, to apply to such payments, any funds that have been appropriated to the University that have not yet been disbursed. Payments under the Financing Agreement are required to be deposited with the Trustee at least ten days prior to the corresponding due date for a payment of any debt service on the Notes. If the amount required to pay debt service is not on deposit by that date, the Trustee is obligated under the Indenture to immediately notify the Secretary of the Cabinet of the default in payment. Under KRS 164A.608, the Secretary of the Cabinet is required, within five days of the default, to remit the amount required to pay debt service to the Trustee from undisbursed funds which have been appropriated to the University.

**Additional Obligations**

The University has reserved the right to issue additional Obligations secured by a pledge of General Receipts. See "EXHIBIT A" – SUMMARY OF THE TRUST AGREEMENT." Those Obligations may be in the form of financing agreements related to the future issuance of notes by the Commission for the University.

**Bond Insurance**

The scheduled payment of principal of and interest on the Notes, when due, will be guaranteed under an insurance policy on the Notes to be issued concurrently with the delivery of the Notes by the Bond Insurer. See "BOND INSURANCE POLICY" and "EXHIBIT F".

## BOND INSURANCE POLICY

The Bond Insurer has supplied the following information for inclusion in this Official Statement. No representation is made by the Commission, the University or the underwriters as to the accuracy or completeness of this information. Reference is made to "EXHIBIT F" for a specimen of the Bond Insurance Policy.

**Payments Under the Policy**

Concurrently with the issuance of the Notes, the Bond Insurer will issue its Municipal Bond New Issue Insurance Policy for the Notes (the "Policy"). The Policy unconditionally guarantees the payment of that portion of the principal or accreted value (if applicable) of and interest on the Notes which has become due for payment, but shall be unpaid by reason of nonpayment by the Commission. Bond Insurer will make such payments to U.S. Bank Trust National Association, or its successor as its agent (the "Fiscal Agent"), on the later of the date on which such principal, accreted value or interest (as applicable) is due or on the business day next following the day on which the Bond Insurer shall have received notice (in accordance with the terms of the Policy) from an owner of Notes or the Trustee of the nonpayment of such amount by the Commission. The Fiscal Agent will disburse such amount due on any Note to its owner upon receipt by the Fiscal Agent of evidence satisfactory to the Fiscal Agent of the owner's right to receive payment of the principal, accreted value or interest (as applicable) due for payment and evidence, including any appropriate instruments of assignment, that all of such owner's rights to payment of such principal, accreted value or interest (as applicable) shall be vested in the Bond Insurer. The term "nonpayment" in respect of a Note includes any payment of principal, accreted value or interest (as applicable) made to an owner of a Note which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

Once issued, the Policy is non-cancellable by the Bond Insurer. The Policy covers failure to pay principal (or accreted value, if applicable) of the Notes on their stated maturity dates and their mandatory sinking fund redemption dates, and not on any other date on which the Notes may have been otherwise called for redemption, accelerated or advanced in maturity. The Policy also covers the failure to pay interest on the stated date for its payment. In the event that payment of the Notes is accelerated, the Bond Insurer will only be obligated to pay principal (or accreted value, if applicable) and interest in the originally scheduled amounts on the originally scheduled payment dates. Upon such payment, the Bond Insurer will become the owner of the Note, appurtenant coupon or right to payment of principal or interest on such Note and will be fully subrogated to all of the rights of the holder thereunder.

The Policy does not insure any risk other than Nonpayment by the Commission, as defined in the Policy. Specifically, the Policy does not cover: (i) payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity; (ii) payment of any redemption, prepayment or acceleration premium; or (iii) nonpayment of principal (or accreted value, if applicable) or interest caused by the insolvency or negligence or any other act or omission of the trustee or paying agent, if any.

As a condition of its commitment to insure Notes, the Bond Insurer may be granted certain rights under the Note documentation. The specific rights, if any, granted to the Bond Insurer in connection with its insurance of the Notes may be set forth in the description of the principal legal documents appearing elsewhere in this Official Statement, and reference should be made thereto.

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

**The Bond Insurer**

The Bond Insurer, a New York stock insurance corporation, is a direct, wholly-owned subsidiary of FGIC Corporation, a Delaware corporation, and provides the financial guaranty insurance for public finance and structured finance obligations. The Bond Insurer is licensed to engage in financial guaranty insurance in all 50 states, the District of Columbia, the U.S. Virgin Islands, the Commonwealth of Puerto Rico and, through a branch, in the United Kingdom.

On December 18, 2003, an investor group consisting of The PMI Group, Inc. ("PMI"), affiliates of The Blackstone Group L.P. ("Blackstone"), affiliates of The Cypress Group L.L.C. ("Cypress") and affiliates of CIVC Partners L.P. ("CIVC") acquired FGIC Corporation (the "FGIC Acquisition") from a subsidiary of General Electric Capital Corporation ("GE Capital"). PMI, Blackstone, Cypress and CIVC acquired approximately 42%, 23%, 23% and 7%, respectively, of FGIC Corporation's common stock. FGIC Corporation paid GE Capital approximately $284.3 million in pre-closing dividends from the proceeds of dividends it, in turn, had received from the Bond Insurer, and GE Capital retained approximately $234.6 million in liquidation preference of FGIC Corporation's convertible participating preferred stock and approximately 5% of FGIC Corporation's common stock. Neither FGIC Corporation nor any of its shareholders is obligated to pay any debts of the Bond Insurer or any claims under any insurance policy, including the Policy, issued by the Bond Insurer.

The Bond Insurer is subject to the insurance laws and regulations of the State of New York, where it is domiciled, including Article 69 of the New York Insurance Law ("Article 69"), a comprehensive the Bond Insurer insurance statute. The Bond Insurer is also subject to the insurance laws and regulations of all other jurisdictions in which it is licensed to transact insurance business. The insurance laws and regulations, as well as the level of supervisory authority that may be exercised by the various insurance regulators, vary by jurisdiction, but generally require insurance companies to maintain minimum standards of business conduct and solvency, to meet certain financial tests, to comply with requirements concerning permitted investments and the use of policy forms and premium rates and to file quarterly and annual financial statements on the basis of statutory accounting principles ("SAP") and other reports. In addition, Article 69, among other things, limits the business of each financial guaranty insurer, including Bond Insurer, to financial guaranty insurance and certain related lines.

For the six months ended June 30, 2005, and the years ended December 31, 2004, and December 31, 2003, the Bond Insurer had written directly or assumed through reinsurance, guaranties of approximately $35.3 billion, $59.5 billion and $42.4 billion par value of securities, respectively (of which approximately 61%, 56% and 79%, respectively, constituted guaranties of municipal bonds), for which it had collected gross premiums of approximately $131.3 million, $323.6 million and $260.3 million, respectively. For the six months ended June 30, 2005, the Bond Insurer had reinsured, through facultative and excess of loss arrangements, approximately 4.2% of the risks it had written.

As of June 30, 2005, the Bond Insurer had net admitted assets of approximately $3.327 billion, total liabilities of approximately $2.152 billion, and total capital and policyholders' surplus of approximately $1.175 billion, determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

The unaudited financial statements of the Bond Insurer as of June 30, 2005, the audited financial statements of the Bond Insurer as of December 31, 2004, and the audited financial statements of the Bond Insurer as of December 31, 2003, which have been filed with the Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs"), are hereby included by specific reference in this Official Statement. Any statement contained herein under the heading "BOND INSURANCE," or in any documents included by specific reference herein, shall be modified or superseded to the extent required by any statement in any document subsequently filed by the Bond Insurer with such NRMSIRs, and shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement. All financial statements of the Bond Insurer (if any) included in documents filed by the Bond Insurer with the NRMSIRs subsequent to the date of this Official Statement and prior to the termination of the offering of the Notes shall be deemed to be included by specific reference into this Official Statement and to be a part hereof from the respective dates of filing of such documents.

The Bond Insurer also prepares quarterly and annual financial statements on the basis of generally accepted accounting principles. Copies of the Bond Insurer's most recent GAAP and SAP financial statements are available upon request to: Financial Guaranty Insurance Company, 125 Park Avenue, New York, NY 10017, Attention: Corporate Communications Department. The Bond Insurer's telephone number is (212) 312-3000.

**Bond Insurer's Credit Ratings**

The financial strength of the Bond Insurer is rated "AAA" by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc., "Aaa" by Moody's Investors Service, and "AAA" by Fitch Ratings. Each rating of the Bond Insurer should be evaluated independently. The ratings reflect the respective ratings agencies' current assessments of the insurance financial strength of the Bond Insurer. Any further explanation of any rating may be obtained only from the applicable rating agency. These ratings are not recommendations to buy, sell or hold the Notes, and are subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the Notes. The Bond Insurer does not guarantee the market price or investment value of the Notes nor does it guarantee that the ratings on the Notes will not be revised or withdrawn.

Neither the Bond Insurer nor any of its affiliates accepts any responsibility for the accuracy or completeness of the Official Statement or any information or disclosure that is provided to potential purchasers of the Notes, or omitted from such disclosure, other than with respect to the accuracy of information with respect to the Bond Insurer or the Policy under the heading "BOND INSURANCE." In addition, the Bond Insurer makes no representation regarding the Notes or the advisability of investing in the Notes.

## THE PROJECT

The Project entails an expansion of and limited renovation to the existing University Hospital, situated adjacent to the existing Hospital Critical Care Center and the Gill Heart Institute, and the addition of a parking structure and overhead concourse (bridge) connector to the new addition.

In general the Project is to contain the following:

1. Hospital Expansion of approximately 1,000,000 gross square feet of building space, with 490,000 square feet to be occupied space of various hospital program elements. An additional 532,000 square feet will be shelled for future program interior fit-up. Program elements include: a new acute care Nursing Unit (152 private patient room beds configured as a 24 bed ICU and four 32-bed med/surg

nursing units); admitting and related support space, linking the new and existing Hospital buildings; 2-MRI Imaging units in one suite; new Emergency Services department with new CT Scan and two R/F X-Ray suites; shell space for new Diagnostic and Treatment Department; new lobby and entrance with related amenities; new Food Services department; new surgery area containing 8 operating room suites; new same day surgery intake and stage two recovery areas; new Central Sterile Supply department; and a new helipad on the roof to access the new Emergency Services Department.

2. Parking Structure containing space for 1,122 cars. The Parking Structure is designed to be expanded vertically for 500 more cars and expanded horizontally for 500 cars.

3. Bridge concourse over South Limestone Street connecting the new parking structure and new hospital expansion. The estimated size is 20 feet in width and 250 feet in length. The juncture of the concourse to the garage will utilize any available space at street level and the concourse level for retail spaces, designed as shell only for future tenant fit-out.

4. Infrastructure expansion to the University's heating and cooling piping loops to include one (1-100,000 BTU/HR) new boiler and four new 2,500 ton chillers.

5. Renovation of existing Critical Care Center and Gill Heart Institute buildings, to interface with the new hospital expansion for operational efficiencies. Renovation is limited to construction required to make new building connections.

6. New entrance drive to support new Hospital Public and Visitor entrance and site improvements for Emergency Services entrance.

## ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of funds are to be applied as follows:

| | |
|---|---|
| Sources | |
| Par Amount of Notes | $107,540,000.00 |
| Plus Original Issue Premium | 2,267,345.55 |
| Total Sources | $109,807,345.55 |
| Uses | |
| Deposit to Project Fund | $100,000,000.00 |
| Deposit to Note Payment Fund (capitalized interest) | 8,754,200.36 |
| Costs of Issuance [1] | 1,053,145.19 |
| Total Uses | $109,807,345.55 |

[1] Includes premium payable to the Bond Insurer with respect to the Bond Insurance Policy, underwriter's discount, legal fees, rating agency fees, printing, and other costs of issuance

## THE UNIVERSITY

The University is a comprehensive, land-grant institution located in Lexington (Fayette County), Kentucky. Founded in 1865 under the provisions of the Morrill Land-Grant Act, the University began as part of Kentucky University. In 1878, the Agricultural and Mechanical College was separated from Kentucky University and reestablished on land given by Lexington and Fayette County. To provide a separate campus for the new institution, Lexington donated its 50-acre fairground and park and, along with Fayette County, contributed construction of the buildings. Thirty years later the name was changed to State University, Lexington, Kentucky, and in 1916 it became the University of Kentucky.

The University is organized into sixteen colleges and graduate schools plus extension programs, and is located in Lexington, Kentucky. From an enrollment of 273 students in 1876, the University has nearly 27,000 students and approximately 11,000 faculty and staff. The campus today has more than 100 major buildings including not only modern teaching and research facilities, but also renovated history-laden structures dating back to the 1800's. The University has produced two Nobel Laureates and seven governors of the Commonwealth including the first female governor. Scientific advances in medicine, energy, equine and other fields of research have caused the University to be ranked among the top 100 research universities in the nation, the only one in Kentucky to be so recognized.

Additional information regarding the University is set forth in "EXHIBIT A."

## THE KENTUCKY ASSET/LIABILITY COMMISSION

### General Information

The Act created the Kentucky Asset/Liability Commission, which is composed of five members, each serving in an ex officio capacity. Under the Act, the members are as follows: the Secretary of the Finance and Administration Cabinet, who acts as Chairman; the Attorney General; the State Treasurer; the Secretary of the Revenue Cabinet and the State Budget Director. Senate Bill 49 of the 2005 General Assembly reorganized the Finance and Administration Cabinet to assume the responsibilities of the former Revenue Cabinet and the Governor's Office of Technology.

The current members of the Commission are as follows:

| | |
|---|---|
| R. B. Rudolph, Jr. | Secretary of the Finance and Administration Cabinet, Chairman |
| Gregory D. Stumbo | Attorney General |
| Jonathan Miller | State Treasurer |
| Bradford L. Cowgill | State Budget Director |

The Secretary to the Commission is the Executive Director of OFM.

The Commission was created by the General Assembly to develop policies and strategies to minimize the impact of fluctuating interest rates on the Commonwealth's interest-sensitive assets and interest-sensitive liabilities. The Commission is authorized to issue tax and revenue anticipation notes, project notes and funding notes. Tax and revenue anticipation notes are to be used for the purpose of providing monies to discharge expenditure demands in anticipation of revenues and taxes to be collected during the fiscal year. Project notes are to be used for authorized projects upon request of the Finance and Administration Cabinet, to be repaid through financing agreements or alternative agreements. Funding notes are to be used for the purpose of funding judgments against the Commonwealth or any state agency. OFM, which is in the Finance and Administration Cabinet, serves as staff to the Commission.

### Financings of the Commission

**General.** Information regarding outstanding notes of the Commission is included in "EXHIBIT C" under the heading "Financings of the Commission."

**Future Financings.** The 2005 Kentucky General Assembly authorized debt financing for projects totaling $2,056,315,300 to support various capital initiatives of the Commonwealth. Of the total authorization, $1,204,589,300 is General Fund supported, $251,726,000 is Agency Restricted Fund supported, $450,000,000 is Road Fund supported and $150,000,000 is Federal Highway Trust Fund supported (Grant Anticipation Revenue Vehicle Bonds).

Except for a $225,000,000 Road Fund supported authorization, the Notes complete the financing plans for the total authorization (excluding the General Fund supported School Facilities Construction Commission authorization). The Commission or another Authority may finance the remaining Road Fund authorization prior to June 30, 2006.

The authorization to issue notes for the purposes described above is in addition to the authority to issue refunding bonds to refund outstanding issues. The Kentucky General Assembly may authorize debt financing to support various capital initiatives of the Commonwealth in future budgets.

## THE FINANCE AND ADMINISTRATION CABINET

The Cabinet, created and governed by the provisions of KRS 12.020 and KRS 42.011, is a statutory administrative organization of the Commonwealth headed by the Secretary of the Cabinet, who is appointed by the Governor. The Secretary of the Cabinet is the chief financial officer of the Commonwealth.

Senate Bill 49 of the 2005 General Assembly reorganized the Finance and Administration Cabinet to assume the responsibilities of the former Revenue Cabinet and the Governor's Office of Technology. In addition to the newly assumed responsibilities, Cabinet functions include, (1) coordination and supervision of the fiscal affairs and fiscal procedures of the Commonwealth; (2) accounting, fiscal reporting and auditing of Commonwealth accounts; (3) purchasing, storekeeping and control of property and stores; (4) the construction, maintenance and operation of public buildings, except those provided for the exclusive use of certain agencies; (5) providing administrative services of a financial nature to other agencies of state government; (6) the investment and management of all Commonwealth funds other than pension funds; and (7) oversight of the issuance and management of all debt incurred in the name of the Commonwealth or any agency thereof.

Under the Act, the Cabinet is required to be a party to the Financing Agreement.

## THE COMMONWEALTH

The Commonwealth of Kentucky, nicknamed the Bluegrass State, was the first state west of the Alleghenies to be settled by pioneers. Kentucky is bounded by the Ohio River to the north and the Mississippi River to the west, and is bordered by the States of Illinois, Indiana, Ohio, West Virginia, Tennessee, Missouri and the Commonwealth of Virginia.

The Commonwealth's economy in many ways resembles a scaled-down version of the U.S. economy in its diversity. The Kentucky economy, once dominated by coal, horses, bourbon and tobacco has become a diversified modern economy including manufacturing of industrial machinery, automobiles and automobile parts and consumer appliances. In addition, Kentucky's nonmanufacturing industries have grown considerably in recent years, with strong gains in air transportation, health and business services, and retail trade. The Commonwealth's parks, horse breeding and racing industry, symbolized by the Kentucky Derby, play an important role in expanding the tourism industry in the Commonwealth.

Additional information regarding the Commonwealth is set forth in "EXHIBIT C."

## SUMMARY OF THE PRINCIPAL DOCUMENTS

Summarized below are certain provisions of the Indenture and the Financing Agreement. This summary does not purport to be complete, and is qualified by reference to the Indenture and the Financing Agreement. UNDER THE FINANCING AGREEMENT, THE UNIVERSITY HAS PLEDGED ITS GENERAL RECEIPTS. A SUMMARY OF THE PROVISIONS OF THE TRUST AGREEMENT UNDER WHICH THE FINANCING AGREEMENT WAS ISSUED IS INCLUDED IN EXHIBIT A UNDER THE HEADING "SUMMARY OF THE TRUST AGREEMENT."

### Definitions

Set forth below are the definitions of some of the terms used in this Official Statement, the Indenture and the Financing Agreement. Reference is made to the Indenture and the Financing Agreement for a complete recital of the terms defined therein.

"Act" shall mean Section 56.860 et seq. of the Kentucky Revised Statutes, as amended.

"Additional Notes" shall mean notes issued under the provisions of Section 2.06(a) of the Indenture.

"Additional Payments" shall mean the Additional Payments payable under the Financing Agreement.

"Authorized Denominations" shall mean $5,000 and integral multiples thereof.

"Authorized Officer" shall mean, as to the Cabinet or the Commission, the Executive Director of the Office of Financial Management and any other officer, member or employee of the Office of Financial Management authorized by a certificate of the Executive Officer to perform the act or sign the document in question, and if there is no such authorization, means the Executive Officer and as to the University, its Treasurer and any other officer, member or employee of the University authorized by a certificate of the Chairman or Secretary of the Board of Trustees of the University to perform the act or sign the document in question.

"Budget Act" shall mean House Bill 267 of the General Assembly of the Commonwealth of Kentucky, 2005 Regular Session.

"Business Day" shall mean any day other than (i) a day on which the Trustee or the Paying Agent is required, or is authorized or not prohibited, by law (including executive orders) to close and is closed and (ii) a day on which the New York Stock Exchange is closed.

"Cabinet" shall mean the Finance and Administration Cabinet of the Commonwealth.

"Commission" shall mean the Kentucky Asset/Liability Commission.

"Cost of Issuance Fund" shall mean the Fund so designated which is established and created by Sections 5.03 and 5.04 of the Indenture.

"Costs of Issuance" shall mean only the costs of issuing Notes as designated by the Commission; including, but not being limited to, the fees and charges of the financial advisors or Underwriter, bond counsel, Trustee, Trustee's counsel, rating agencies, note and official statement printers and such other fees and expenses normally attendant to an issue of the Notes.

"Counsel" or "Counsel's Opinion" shall mean an opinion signed by such attorney or firm of attorneys of recognized national standing in the field of law relating to municipal bonds and municipal finance as may be selected by the Commission.

"Debt Servicing Date" shall mean any Interest Payment Date, as defined in the Indenture.

"Debt Servicing Obligation" shall mean the aggregate amounts required to be paid in respect of the Notes on any Debt Servicing Date, including (i) the scheduled maturity of principal of any Notes maturing on such Debt Servicing Date and the principal amount of Notes, if any, called for redemption on such Debt Servicing Date, and the premium, if any, with respect to such Notes, (ii) the interest required or estimated (by the Commission) to be paid on the Notes, and (iii) the reasonable and agreed fees of the Trustee, the Paying Agent and the Registrar, but only to the extent not otherwise paid directly by the Cabinet. The Cabinet shall be entitled to a credit against the Debt Servicing Obligation otherwise required to be paid on any Debt Servicing Date to the extent there are funds in the Interest Account of the Note Payment Fund prior to the payment of the Debt Servicing Obligation hereunder which, under the terms of the Indenture and applicable law, can be used to meet the Debt Servicing Obligation. It is understood that, pursuant to the Indenture, all income derived from investment of the Project Fund may, at the discretion of the Cabinet, be transferred to the Note Payment Fund and, if so transferred, shall be a credit against Financing Payments due and payable by the Cabinet. Amounts transferred from the Cost of Issuance Fund, established by the Indenture, to the Note Payment Fund, shall be a further credit against Financing Payments due and payable by the Cabinet.

"Eligible Investments" shall mean any investment authorized by Section 42.500 of the Kentucky Revised Statutes, as the same may be amended from time to time.

"Executive Officer" shall mean the Chairman of the Commission.

"Fiduciary" or "Fiduciaries" shall mean the Trustee, any Paying Agent or Agents, or any combination of them, as may be appropriate.

"Financing Agreement" shall mean the Financing/Lease Agreement, dated as of November 1, 2005 among the Commission, the Cabinet and the University by which the Project is leased to the University, and any amendments or supplements thereto.

"Financing Payments" shall mean Financing Payments payable under the Financing Agreement.

"Fitch" shall mean Fitch Ratings.

"Funds and Accounts" shall mean the Cost of Issuance Fund, Note Payment Fund, Project Fund and Rebate Fund and the accounts within such funds established by the Trust Indenture

"Holder", or "Owner", or any similar term (when used with reference to Notes), shall mean the person in whose name a Note is registered.

"Indenture" or "Trust Indenture" shall mean the Indenture, dated as of November 1, 2005, and entered into between the Commission and the Trustee, as amended or supplemented from time to time.

"Interest Account" shall mean the account by that name in the Note Payment Fund established under the Indenture.

"Interest Payment Date" shall mean each April 1 and October 1, commencing April 1, 2006.

"Memorandum of Instructions" shall mean a Memorandum of Instructions Regarding Rebate which may be delivered to the Commission and the Trustee at the time of the issuance and delivery of the Notes, as the same may be amended or supplemented in accordance with its terms.

"Moody's" shall mean Moody's Investors Service, Inc.

"Note Payment Fund" shall mean the Fund so designated which is established and created by Sections 5.03 and 5.05 of the Indenture.

"Notes" shall mean the Commission's University of Kentucky General Receipts Project Notes, 2005 Series A, issued from time to time under the provisions of the Indenture.

"Outstanding" when used with reference to Notes, shall mean, as of any date, all Notes theretofore or then being authenticated and delivered under the Indenture except:

(a) Notes cancelled upon surrender, exchange or transfer or cancelled because of payment or redemption at or prior to such date;

(b) Notes for the payment, redemption or purchase for cancellation of which sufficient moneys have been deposited and credited for the purpose on or prior to that date in the Note Payment Fund (whether upon or prior to the maturity or Redemption Date of those Notes); provided that if any of those Notes are to be redeemed prior to their maturity, notice of that redemption shall have been given or arrangements satisfactory to the Trustee shall have been made for giving notice of that redemption, or waiver by the affected Noteholders of that notice satisfactory in form to the Trustee shall have been filed with the Trustee, and provided further that if any of those Notes are to be purchased for cancellation a firm offer for sale stating the price shall have been received and accepted;

(c) Notes which are deemed to have been paid pursuant to the provisions of Article IX of the Indenture or any Notes which are deemed to have been paid pursuant to the provisions of the Indenture; and

(d) Notes in lieu of which others have been authenticated under Sections 3.07, 3.08 and 3.11 of the Indenture.

"Paying Agent" shall mean initially, the Trustee, and any bank or trust company so designated, and its successor or successors hereafter appointed, as paying agent for the Notes in the manner provided in the Indenture.

"Pledged Receipts" shall include:

(i) all of the Financing Payments and Additional Payments, as defined in the Financing Agreement, to be paid by the University to the Commission pursuant to the Financing Agreement; and

(ii) all interest earned and gains realized on Eligible Investments (a) except for earnings and gains on any investments in the Rebate Fund and (b) unless this Trust Indenture specifically requires such interest earned or gains realized to remain in a particular Fund or Account and does not therefore constitute a Pledged Receipt.

"Principal Account" shall mean the account by that name in the Note Payment Fund established under Section 5.05 of the Indenture.

"Project" shall mean the Patient Care Facility - Hospital, authorized for the University by the Budget Act and described in the Financing Agreement.

"Project Fund" shall mean the Project Fund created by Sections 5.03 and 5.06 of the Indenture.

"Rating Service" shall mean Moody's, if Moody's is then rating the Notes, S&P, if S&P is then rating the Notes, and Fitch, if Fitch is then rating the Notes, and their respective successors and assigns.

"Rebate Fund" shall mean a fund by that name established pursuant to Sections 5.03 and 5.07 of the Indenture.

"Record Date" shall mean the first day of the month next preceding the applicable Interest Payment Date.

"Redemption Date" shall mean the date established for the redemption of Notes as described under the heading "THE NOTES – Redemption."

"Refunding Notes" shall mean notes issued under the provisions of Section 2.06(b) of the Indenture, the proceeds of which are used solely and only to refund a portion of the Notes then Outstanding under the Indenture and to pay the costs of issuing such Refunding Notes.

"Registrar" shall mean the registrar maintaining the registration books for any Notes.

"Resolution" shall mean the resolution of the Commission adopted October 17, 2005 authorizing the issuance of the Notes and the execution and delivery of the Indenture.

"S&P" shall mean Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc.

"State" shall mean the Commonwealth of Kentucky.

"University" shall mean University of Kentucky.

"Supplemental Trust Indenture" shall mean any trust indenture supplemental to or amendatory of the Indenture adopted by the Commission in accordance with the Indenture.

"Treasurer" shall mean the Treasurer of the State.

"Trust Estate" shall mean the trust estate created by the Indenture and by the pledges specifically set forth in Section 5.02 of the Indenture.

"Trustee" shall mean the Trustee appointed pursuant to Section 9.01 of the Indenture, and its successor or successors, and any other corporation which may at any time be substituted in its place pursuant to the Indenture.

**The Indenture**

Delivery of the Notes. The Indenture authorizes the issuance of the Notes in the aggregate amount set forth on the cover page hereto. All Notes issued under the Indenture will rank on a parity and equality with one another and are entitled to the benefit of the continuing pledge and lien created by the Indenture to secure the full and final payment of the principal of and interest on the Notes. (Section 2.04)

Additional Notes; Refunding Notes. The Indenture provides that if the proceeds of the Notes, plus other available funds, are not sufficient to complete the Project, the Commission, pursuant to the Indenture, is required to authorize, issue, sell and deliver a sufficient amount, but only a sufficient amount, of Additional Notes which will be fully on a parity with and have the same security as the Notes, in order to complete the Project for its intended uses and purposes. Additional Notes may also be issued pursuant to the Indenture, if at any time insurance proceeds are insufficient to make repairs or replace portions of the Project which have been damaged, but only a sufficient amount, of Additional Notes in order to make such necessary repairs and replacements, subject to any limitations on the issuance of such notes as may then exist under the Kentucky Revised Statutes.

No Additional Notes on a parity as to security with the Notes for such specific purposes provided for in the Indenture, may be issued unless at such time the Commission is and has been in continuous compliance with all of the provisions with reference to the payment of the principal and interest with respect to the Notes and is and has been in continuous compliance with the Indenture. If any Additional Notes for such purposes are issued on a basis of parity as to security with the Notes, the Financing Agreement shall be amended to provide for payments sufficient to pay the principal and interest with respect to all Notes Outstanding under the Indenture and all Additional Notes.

No other Additional Notes may be issued at any time secured by the Pledged Receipts except and unless such pledge is made subject and subordinate to the priority of the pledges made in the Indenture to secure the Notes.

The Commission reserves the right to issue Refunding Notes which may be on a parity as to security with the Notes in order to refund any Notes then Outstanding under the Indenture.

No Refunding Notes on a parity as to security with the Notes may be issued unless at such time the Commission is and has been in continuous compliance with all of the provisions with reference to the payment of the principal and interest with respect to the Notes and is and has been in continuous compliance with all of the covenants under the Indenture. (Section 2.06)

The Pledge Effected By The Indenture. Pursuant to the Act and the Indenture, there is pledged for the payment of the principal of and interest on the Notes, payable in accordance with their terms and the provisions of the Indenture, subject only to the provisions of the Indenture permitting the application thereof for or to the purposes and on the terms and conditions set forth in the Indenture, (i) the proceeds of sale of the Notes, (ii) Eligible Investments acquired from Note proceeds or by application of moneys in Funds and Accounts (subject to the limitations of (iv) below), (iii) the Pledged Receipts, and (iv) all Funds and Accounts created and established pursuant to the Indenture other than the Rebate Fund, including moneys and securities therein. (Section 5.02)

Establishment of Funds. The Indenture establishes (i) the Cost of Issuance Fund; (ii) the Note Payment Fund; (iii) the Project Fund; (iv) the Rebate Fund and (v) such other Funds and Accounts which may be created from time to time in order to accomplish the purposes of the Act and the Indenture and which are not inconsistent with the requirements of the Indenture. Each of the above Funds, in addition to other Accounts from time to time established, are required to be held and maintained by the Trustee pursuant to the provisions of the Indenture, except for the Project Fund, which is required to be held by the Treasurer. (Section 5.03)

Cost of Issuance Fund. The Indenture establishes and creates a separate Cost of Issuance Fund. There will be deposited in the Cost of Issuance Fund, the amount required by the Indenture. The Trustee is required from time to time pay out, or permit the withdrawal of, moneys from the Cost of Issuance Fund, free and clear of any lien or pledge or assignment in trust created by the Indenture, for the purpose of paying, any Costs of Issuance, upon receipt by the Trustee of a written requisition of the Commission signed by an Authorized Officer of the Commission stating with respect to each payment to be made, the Costs of Issuance to be so paid.

If any moneys remain in the Cost of Issuance Fund on the date which is five months from the date of issuance of the Notes, the Trustee is required to transfer such amounts to the Note Payment Fund. (Section 5.04)

Note Payment Fund. The Indenture establishes and creates a separate Note Payment Fund. In addition to any other Accounts deemed necessary by the Trustee, the Indenture establishes within the Note Payment Fund the following:

An Interest Account, into which will be deposited all amounts (i) received as accrued interest upon the sale and delivery of any Notes and (ii) received as the interest portion of Financing Payments (including any prepayments of the interest portion of Financing Payments).

A Principal Account, into which will be deposited all amounts (i) transferred from the Project Fund to pay principal of and premium, if any, on the Notes due at maturity, on a Redemption Date or upon acceleration; (ii) received as the principal portion of Financing Payments (including any prepayments of the principal portion of Financing Payments); and (iii) representing proceeds of and premium, if any, on Notes to pay principal of the Notes at maturity on a Redemption Date, or upon acceleration.

Amounts in the Interest Account are required to be used to pay interest on the Notes. Amounts in the Principal Account will be used to pay principal of and premium, if any, on the Notes.

The Indenture requires the Trustee to transmit to any Paying Agent, as appropriate, from moneys in the Note Payment Fund applicable thereto, amounts sufficient to make timely payments of principal of, interest on and premium, if any, on the Notes to be made by such Paying Agent and then due and payable. (Section 5.05)

Project Fund. The Indenture establishes and creates a trust fund to be designated the Project Fund, which is required to be an account in the Commonwealth's management administrative and reporting system. The Project Fund is required to be separately identified from all other accounts in the Commonwealth's management administrative and reporting system and is required to be used solely for the purposes provided in the Indenture. The proceeds of the issuance and delivery of the Notes equal to the amount authorized for the Project by the Budget Act, are required to be deposited in the Project Fund. Under the Indenture, the Treasurer makes disbursements from the Project Fund on a first-in-first-out basis in accordance with and as required by the provisions of written requisitions filed from time to time by an Authorized Officer of the University and in accordance with the provisions of the Financing Agreement. The University is required to keep and maintain adequate records pertaining to the Project Fund and all disbursements therefrom. All of the income derived from investment of the Project Fund will, at the option of the University, be transferred as received to the Note Payment Fund and disbursed therefrom on the next succeeding Interest Payment Date or held in the Project Fund and used for the purposes thereof. If any amount remains in the Project Fund after an Authorized Officer of the University certifies that the Project has been completed, such amount shall be transferred to the Interest Account of the Note Payment Fund. (Section 5.06)

Rebate Fund. The Indenture establishes and creates a trust fund to be designated the Rebate Fund, which is established and maintained under the Indenture or under any laws governing the creation and use of funds by the Commission. If a Series of Notes is determined to be subject to the "rebate" requirements in favor of the United States of America imposed by the Code, there will be deposited in the Rebate Fund such amounts as are required to be deposited therein pursuant to the related Memorandum of Instructions. Subject to the transfer provisions provided in Section 5.07 of the Indenture, all money at any time deposited in the Rebate Fund will be held by the Trustee in trust, to the extent required to satisfy the Rebate Amount (as defined in the Memorandum of Instructions), for payment to the federal government of the United States of America, and neither the Commission, nor the owner of any Notes will have any rights in or claim to such money. All amounts deposited into or on deposit in the Rebate

Fund will be governed by Article V of the Indenture, and by the Memorandum of Instructions. The Trustee will be deemed conclusively to have complied with such provisions if it follows the directions of the Commission including supplying all necessary information in the manner provided in the Memorandum of Instructions, and will have no liability or responsibility to enforce compliance by the Commission with the terms of the Memorandum of Instructions.

Upon the Commission's written direction, an amount is required to be deposited to the Rebate Fund by the Trustee from deposits by the Commission, if and to the extent required, so that the balance of the Rebate Fund after such deposit equals the Rebate Amount for the Bond Year (as such term is defined in the Memorandum of Instructions) calculated as of the most recent Calculation Date (as defined in the Memorandum of Instructions). Computations of the Rebate Amount are required to be furnished by or on behalf of the Commission in accordance with the Memorandum of Instructions.

The Trustee will have no obligation to rebate any amounts required to be rebated pursuant to Section 5.07 of the Indenture, other than from moneys held in the Funds and Accounts or from other moneys provided to it by the Commission.

The Trustee is required to, upon written direction, invest all amounts held in the Rebate Fund, subject to the restrictions set forth in the Indenture for investments in other funds established in the Indenture and in the Memorandum of Instructions. The Trustee will retain all earnings (calculated by taking into account net gains or losses on sales or exchanges and taking into account amortized discount or premium as a gain or loss, respectively) on investments held in the Rebate Fund in the Rebate Fund. Moneys will not be transferred from the Rebate Fund except as provided in the following paragraph.

Upon receipt of the Commission's written directions, the Trustee shall remit part or all of the balances in the Rebate Fund to the United States, as so directed. In addition, if the Commission so directs, the Trustee will deposit moneys into or transfer moneys out of the Rebate Fund from or into such account or funds as directed by the Commission's written directions. Any funds remaining in the Rebate Fund after redemption and payment of all of the Notes and payment and satisfaction of any Rebate Amount, or provision made therefore satisfactory to the Trustee shall be withdrawn and remitted to, or at the direction of, the Commission.

Notwithstanding any other provision of the Indenture, the obligation to remit the Rebate Amounts to the United States and to comply with all other requirements of Section 5.07 of the Indenture and the Memorandum of Instructions will survive the defeasance or payment in full of the Notes. (Section 5.07)

Investment of Funds. The Indenture requires amounts on deposit in any Fund or Account to be invested in Eligible Investments, and for the Trustee to sell at the best price reasonably obtainable, or present for redemption or exchange, any Eligible Investments purchased by it as an investment pursuant to the Indenture whenever it will be necessary in order to provide moneys to meet any payment or transfer from the Fund or Account from which such investment was made. Except as otherwise provided in the Indenture, earnings and losses on Eligible Investments are required to be credited to the Fund or Account with respect to which such investments were made (or pro-rated thereto) and will become a part thereof for all purposes, except as otherwise provided in the Indenture. (Section 5.08)

Further Assurance. The Indenture requires the Commission, so far as it may be authorized by law, to pass, make, do, execute, acknowledge and deliver, all and every such further resolutions, acts, deeds, conveyances, assignments, transfers and assurances as may be necessary or desirable for the better assuring, conveying, granting, assigning and confirming all and singular the rights, assets and revenues pledged and assigned, or intended so to be, or which the Commission may become bound to pledge or assign. (Section 6.04)

Powers as to Notes and Pledge. Under the Indenture, the Commission is authorized to issue the Notes and execute and deliver the Indenture and pledge the income, revenues and assets pledged by the Indenture in the manner and to the extent provided in the Indenture. The income, revenues and assets pledged are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Indenture, and all official action on the part of the Commission to that end has been or will be duly and validly taken. The Notes and the provisions of the Indenture are and will be the valid and legally enforceable obligations of the Commission in accordance with their terms and the terms of the Indenture. The Budget Act includes authorization for the issuance of "bonds" (being the Notes) for the Project and includes adequate funds for the payment of Financing Payments and Additional Payments under the Financing Agreement. The Commission is required to at all times, to the extent permitted by law, defend, preserve and protect the pledge of the incomes, revenues and assets pledged under the Indenture and all the rights of the Holders under the Indenture against all claims and demands therefore of all persons whomsoever. (Section 6.05)

Covenants as to Financing Payments and Additional Payments. The Indenture establishes that the Financing Agreement will continue to be maintained by the Commission. In the event the University for any reason whatsoever fails to pay any Financing Payments or Additional Payments specified in the Financing Agreement, the Commission will use its best efforts to make or cause to be made payments of Financing Payments or Additional Payments so that the aggregate of the gross receipts and revenues from the Financing Agreement at all times will be sufficient to make such prescribed payments into the Note Payment Fund; provided, however, that in the event of any failure of the University to make its payments as aforesaid, no action shall be taken which, in Counsel's opinion, would have the effect of materially altering the federal income tax status of the interest earned on the Notes.

If, at any time, the prescribed Financing Payments under the Financing Agreement are not sufficient to pay the principal of and the interest on the Notes authorized in the Indenture or Additional Payments are not sufficient to pay fees and expenses related to the Notes, in accordance with the provisions of the Indenture, such Financing Payments or Additional Payments are required to be immediately adjusted in order to produce sufficient revenues for such purposes. (Section 6.08)

Covenant to Confer with Appropriate Officials Concerning Biennial Budget. The Commission will, prior to the beginning of each fiscal biennium confer with the proper officials of the University to induce the University to include in its budget such provisions and arrangements as may be required and appropriate to continue to pay the prescribed Financing Payments and Additional Payments during such biennial period. (Section 6.09)

Covenant to Enforce the Financing Agreement. So long as any of the Notes are Outstanding and unpaid as to either principal or interest, the Commission will continuously enforce the Financing Agreement to the maximum extent permitted by law, and will not consent to any modification of the Financing Agreement which would in any particular way impair the security created for the holders of the Notes. (Section 6.10)

Tax Covenant. The Commission is required to do and perform all acts and things permitted by law and necessary or desirable in order to assure that interest paid by the Commission on the Notes will, for the purposes of federal income taxation, be excludable from gross income under any valid provision of law including but not limited to, provisions of the Code and Section 122 of Title 23, as applicable.

The Commission will not permit at any time or times any of the proceeds of the Notes to be used to acquire or to replace funds which were used directly or indirectly to acquire any securities or obligations which are "higher yielding investments" (as defined in the Code), the acquisition of which would cause any Note to be an "arbitrage bond" as defined in Sections 103(b)(2) and 148 of the Code as then in effect, unless, under any valid provision of law hereafter enacted (i) such action would not cause arbitrage bond status to occur, or (ii) the interest paid by the Commission on the Notes will be excludable from the gross income of a recipient thereof for federal income tax purposes without regard to compliance with the provisions of Section 103(a) of the Code.

In order to assure compliance with Section 6.11 of the Indenture, thereby better securing and protecting the Notes, the Commission from the date of adoption of the Indenture will not:

(1) make or cause to be made any investment of Note proceeds that produces a yield in excess of such applicable maximum yield as may be permitted by the Code, and

(2) invest or cause the Trustee (or the Treasurer, as the case may be) to, and the Trustee (or the Treasurer, as the case may be) shall not, independent of any direction of the Commission, invest monies in any fund created under the Indenture in investment obligations that produce a yield in excess of such applicable maximum yield as may be permitted by the Code.

The Commission prior to the issuance of any of the Notes and as a condition precedent to such issuance, the Commission is required to certify by issuance of a certificate by an Authorized Officer having responsibility for the receipt, disbursement, use and investment of the proceeds of the Notes that, on the basis of the facts, estimates and circumstances in existence on the date of issue of the Notes it is not expected that the proceeds of the Notes will be used in a manner that would cause such obligations to be arbitrage bonds.

The Commission is required to pay from time to time all amounts required to be rebated to the United States pursuant to Section 148(f) of the Code and any temporary, proposed or final Treasury Regulations as may be applicable to the Notes from time to time. This requirement will survive payment in full or defeasance of the Notes. The Commission is required to pay or cause to be paid to the United States at the times and in the amounts determined under Section 5.07 of the Indenture the Rebate Amounts, as described in the Memorandum of Instructions. The Trustee is required to comply with all instructions of the Commission given in accordance with the Memorandum of Instructions.

Notwithstanding any provision described under this heading, if the Commission will provide to the Trustee a Counsel's opinion to the effect that any action required under Sections 6.11 and 5.07, of the Indenture is no longer required, or to the effect that some further action is required, to maintain the exclusion from gross income of the interest on the Notes pursuant to Section 103(a) of the Code, the Commission and the Trustee may rely conclusively on such opinion in complying with those provisions. (Section 6.11)

Supplemental Trust Indentures Effective Without Consent of Holders. The Indenture prescribes procedures whereby the Commission may, with the written consent of the Trustee, execute and deliver at any time from time to time Supplemental Trust Indentures for any one or more of the following purposes; to further secure the payment of the Notes; to further limit and restrict the issuance of Notes and the incurring of indebtedness by the Commission; to surrender any right, power or privilege reserved to or conferred upon the Commission by the terms of the Indenture, to confirm any pledge under and the subjection to any lien, claim or pledge created or to be created by the provisions of the Indenture; to modify any of the provisions of the Indenture in any other respects (provided that such modifications will not be effective until after all Notes outstanding as of the date of execution and delivery of such Supplemental Trust Indenture cease to be Outstanding; to cure any ambiguity or defect or inconsistent provision; and for any other purpose provided that, in the opinion of Counsel, any such amendment or modification does not materially adversely affect the rights of Holders affected thereby.

A Supplemental Trust Indenture for the purposes described above, becomes effective upon the execution thereof by the Commission and the Trustee and delivery thereof to the Trustee. At any time thereafter, notice stating in substance that the Supplemental Trust Indenture has been delivered to the Trustee and is effective pursuant to the Indenture, is required to be given to Holders by the Commission by mailing such notice to Holders by regular United States mail. (Section 7.01)

Supplemental Trust Indentures Effective with Consent of Holders. The Indenture may also be modified or amended at any time or from time to time by a Supplemental Trust Indenture, subject to the written consent of the Holders in accordance with and subject to the provisions of Article VIII of the Indenture. (Section 7.02)

Supplemental Trust Indentures Effective with Counsel's Opinion. A copy of every Supplemental Trust Indenture adopted by the Commission when filed with the Trustee is required to be accompanied by a Counsel's Opinion stating that such Supplemental Trust Indenture has been duly and lawfully adopted in accordance with the provisions of the Indenture, is authorized or permitted by the Indenture and is valid and binding upon the Commission and enforceable in accordance with its terms. (Section 7.03)

Limitations on Powers of Amendment. Any modification or amendment of the Trust Indenture and of the rights and obligations of the Commission and of the Holders of the Notes pursuant to may be made by a Supplemental Trust Indenture, with the written consent given by the Holders of at least a majority in principal amount of the Notes Outstanding at the time such consent is given. No modification or amendment may permit a change in the terms of redemption or maturity of the principal of any Outstanding Note or of any installment of interest thereon or a reduction in the principal amount thereof or in the rate of interest thereon without the consent of the Holder of such Note, or reduce the percentages or otherwise affect the classes of Notes the consent of the Holders of which is required to effect any such modification or amendment. (Section 8.01)

Consent of Holders. A copy of a Supplemental Trust Indenture requiring consent of the Holders, or summary thereof, together with a request to the Holders must be mailed to the Holders. Such Supplemental Trust Indenture will not be effective unless and until (a) there shall have been filed with the Trustee (i) the written consents of the proper percentage of Holders and (ii) a Counsel's Opinion, and (b) notice thereof must have been mailed to all Holders. Any such consent will be binding upon the Holder of the Notes giving such consent and, upon any subsequent Holder of such Notes and of any Notes issued in exchange therefore (whether or not such subsequent Holder thereof has notice thereof), unless such consent is revoked in writing by the Holder of such Notes giving such consent or a subsequent Holder thereof by filing with the Trustee, prior to the time when the written statement of the Trustee described in this paragraph is filed, such revocation.

At any time thereafter, notice, stating in substance that the Supplemental Trust Indenture (which may be referred to as a Supplemental Trust Indenture adopted by the Commission on a stated date, a copy of which is on file with the Trustee) has been consented to by the Holders of the required percentages of Notes and will be effective as described in this paragraph, is required to be given to the Holders by the Commission by mailing such notice to the Holders. A transcript, consisting of the papers described in this paragraph to be filed with the Trustee, will be proof of the matters therein stated. Such Supplemental Trust Indenture making such amendment or modification will be deemed conclusively binding upon the Commission, the Fiduciaries and the Holders of all Notes. (Section 8.02)

Events of Default. Each of the following events shall constitute an "Event of Default":

(1) payment of any principal on any Note shall not be made when and as the same shall become due or upon call for redemption or otherwise; or

(2) payment of any installment of interest on any Note shall not be made when and as the same shall become due; or

(3) the Commission shall fail or refuse to comply with the provisions of the Act, or shall default in the performance or observance of any other of the covenants, agreements or conditions on its part contained in the Indenture or the Notes and such failure, refusal or default shall continue for a period of forty-five (45) days after written notice thereof by the Trustee or the

Holders of not less than five percent (5%) in principal amount of the Outstanding Notes. (Section 9.02)

Acceleration. Subject to provisions described in this paragraph and upon the occurrence of an Event of Default as specified in paragraphs (1) or (2) above, the Trustee is required to declare, by a notice in writing delivered to the Commission, the principal of all Notes then outstanding (if not then due and payable), together with interest accrued thereon, to be due and payable immediately. Upon the occurrence of any other Event of Default, the Trustee may, or at the direction of the Holders of not less than twenty-five percent (25%) of the Notes Outstanding is required to, declare, by a notice in writing delivered to the Commission, the principal of all Notes then outstanding (if not then due and payable), together with interest accrued thereon, to be due and payable immediately.

Any such declaration is required to be by notice in writing to the Commission, and, upon said declaration, principal and interest on all Notes will become and be immediately due and payable. The Trustee immediately upon such declaration is required to give notice thereof in the same manner as provided in the Indenture with respect to the redemption of the Notes without regard to the times stated for notice of redemption that the payment of principal and interest will be tendered immediately to the Holders of the Notes and that interest has ceased to accrue as of the date of such declaration of acceleration. Nothing contained in the Indenture shall be construed to permit the acceleration of any payments of Financing Payments or Additional Payments by the University beyond the current term of the Financing Agreement. (Section 9.03)

Other Remedies. Upon the occurrence of an Event of Default specified in paragraphs (1) or (2) above, the Trustee is required to proceed, or upon the happening and continuance of any other Event of Default specified in paragraph (3) above, the Trustee may proceed, and upon the written request of the Holders of not less than twenty-five percent (25%) of the Outstanding Notes is required to proceed, in its own name, subject to the provisions described in this paragraph, to protect and enforce its rights and the rights of the Holders by such suits, actions or special proceedings in equity or at law, or by proceedings in the office of any board or officer having jurisdiction, whether for the specific performance of any covenant or agreement contained in the Indenture or in aid of the execution of any power granted therein or in the Act or for the enforcement of any legal or equitable rights or remedies as the Trustee, being advised by its counsel, will deem most effectual to protect and enforce such rights or to perform any of its duties under the Indenture.

In the enforcement of any rights and remedies under the Indenture, the Trustee will be entitled to sue for, enforce payment on and receive any and all amounts then or during any default becoming, and at any time remaining, due and unpaid from the Commission for principal, interest or otherwise, under any provision of the Indenture or of the Notes, with interest on overdue payments at the rate or rates of interest specified in such Notes, together with any and all costs and expenses of collection and of all proceedings under the Indenture and under the Notes, without prejudice to any other right or remedy of the Trustee or of the Holders, and to recover and enforce a judgment or decree against the Commission, but solely as provided in the Indenture and in the Notes for any portion of such amounts remaining unpaid, with interest, costs and expenses, and to collect in any manner provided by law, the moneys adjudged or decreed to be payable. (Section 9.04.)

Priority of Payments After Default. In the event that upon the happening and continuance of any Event of Default the funds held by the Fiduciaries are insufficient for the payment of principal and interest then due on the Notes, such funds (other than funds held for the payment or redemption of particular Notes which have theretofore become due at maturity or by call for redemption) and any other moneys received or collected by the Trustee acting pursuant to the Act and the Indenture, after making provision (i) for the payment of any expenses necessary in the opinion of the trustee to protect the interests of the Holders of the Notes and (ii) for the payment of the charges and expenses and liabilities incurred and advances made by the Fiduciaries in the performances of their respective duties under the Trust Indenture, will be applied as follows:

(1) Unless the principal of all of the Notes shall have become or have been declared due and payable:

First: To the payment to the persons entitled thereto of all installments of interest then due in the order of the maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installments, then to the payment thereof ratably, accordingly to the amounts due on such installments, to the persons entitled thereto, without any discrimination or preference; and

Second: To the payment to the persons entitled thereto of the unpaid principal of any Notes which shall have become due, whether at maturity or by call for redemption, in the order of their due dates and, if the amounts available shall not be sufficient to pay in full all the Notes due on any date, then to the payment thereof ratably, according to the amounts of the principal due on such date, to the persons entitled thereto, without any discrimination or preference.

(2) If the principal of all of the Notes shall have become or have been declared due and payable, to the payment of the principal and interest due and unpaid upon the Notes without preference or priority of principal over interest or of interest over principal, or of any installment of interest over any other installment of interest, or of any Note over any other Note, ratably, accordingly to the amounts due respectively for principal and interest, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Notes.

Whenever moneys are to be applied by the Trustee as described herein, such moneys are required to be applied by the Trustee at such times, and from time to time, as the Trustee in its sole discretion shall determine, having due regard to the amount of such moneys available for application and the likelihood of additional money becoming available for such application in the future. The deposit of such moneys with the Fiduciaries, or otherwise setting aside such moneys in trust for the proper purpose, shall constitute proper application by the Trustee, and the Trustee will incur no liability whatsoever to the Commission, to any Holder or to any other person for any delay in applying any such moneys, so long as the Trustee acts with reasonable diligence, having due regard for the circumstances, and ultimately applies the same in accordance with such provisions of the Trust Indenture as may be applicable at the time of application by the Trustee. Whenever the Trustee exercises such discretion in applying such moneys, it will fix the date (which shall be an Interest Payment Date unless the Trustee shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue. The Trustee is required to give such notice as it may deem appropriate for the fixing of any such date. The Trustee is not required to make payment to the Holder of any unpaid Note unless such Note shall be presented to the Trustee for appropriate endorsement or for cancellation if fully paid. (Section 9.05)

<u>Direction of Proceedings</u>. Anything in the Indenture to the contrary notwithstanding, the Holders of the majority in principal amount of Notes then Outstanding will have the right by an instrument or concurrent instruments in writing executed and delivered to the Trustee, to direct the method of conducting all remedial proceedings to be taken by the Trustee under the Indenture, provided that such direction will not be otherwise than in accordance with law or the provisions of the Indenture, and that the Trustee will have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Holders not parties to such direction. (Section 9.07)

<u>Limitation on Rights of Holders</u>. No Holder of any Note will have any right to institute any suit, action, mandamus or other proceeding in equity or at law under the Indenture, or for the protection or enforcement of any right under the Indenture or any right under the law unless such Holder has given to the Trustee written notice of the Event of Default or breach of duty on account of which such suit, action or proceeding is to be taken, and unless the Holders of not less than twenty-five percent (25%) of the Notes then Outstanding have made written request of the Trustee after the right to exercise such powers

or right of action, as the case may be, have occurred, and have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers granted in the Indenture or granted under the law or to institute such action, suit or proceeding in its name and unless, also, there shall have been offered to the Trustee reasonable security and indemnity against the cost, expenses (including reasonable legal expenses) and liabilities to be incurred therein or thereby, and the Trustee shall have refused or neglected to comply with such request within a reasonable time, it being understood that the Trustee is required to make all payments on the Notes as provided in the Indenture (to the extent funds are available for such purpose) and declare the Notes due and payable as provided in the Indenture, regardless of having received any indemnity or security; and such notification, request and offer of indemnity are in every such case, at the option of the Trustee, to be conditions precedent to the execution of the powers under the Indenture or for any other remedy under the Indenture or under law. It is understood and intended that no one or more Holders of the Notes will have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Indenture, or to enforce any right under the Indenture or under law with respect to the Notes or the Indenture, except in the manner provided in the Indenture, and that all proceedings at law or in equity shall be instituted, had and maintained in the manner provided in the Indenture and for the benefit of all Holders. Nothing in the Article contained will affect or impair the right of any Holder to enforce the payment of the principal of and interest on its Notes, or the obligation of the Commission to pay the principal of and interest on each Note issued under the Indenture to the Holder thereof at the time and place stated in said Note.

Anything in the Indenture to the contrary notwithstanding, each Holder of any Note by his acceptance thereof will be deemed to have agreed that any court in its discretion may require, in any suit for the enforcement of any right or remedy under the Indenture or in any suit against the Trustee for any action taken or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the reasonable cost of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys' fees, against any party litigant in any such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant; but the provisions described in this paragraph will not apply to any suit instituted by the Trustee, to any suit instituted by any Holder, or group of Holders, holding at least twenty-five percent (25%) of the Notes Outstanding, or to any suit instituted by any Holders for the enforcement of the payment of the principal of, premium, if any, or interest on any Note on or after the respective due date thereof expressed in such Note. (Section 9.08)

Trustee. Prior to the occurrence of an Event of Default, the Trustee is required to perform only those duties specifically set forth in the Indenture. If an Event of Default, of which the Trustee has received notice, has occurred and is continuing, the Trustee is required to exercise its rights and powers and use the same degree of care and skill as a prudent man would exercise under the circumstances in the conduct of his own affairs. (Section 10.01)

Evidence on Which Fiduciaries May Act. Each Fiduciary will be protected in acting upon any notice, resolution, request, consent, order, certificate, report, opinion, note, or other paper or document believed by it to be genuine, and to have been signed or presented by the proper party or parties. Each Fiduciary may consult with counsel, who may or may not be of counsel to the Commission, and the opinion of such counsel will be full and complete authorization and protection in respect of any action taken or suffered by it under the Indenture in good faith and in accordance therewith. Whenever any Fiduciary will deem necessary or desirable that a matter be proved or established prior to taking or suffering any action under the Indenture, including payment of moneys out of any Fund or Account, such matter (unless other evidence in respect thereof be specifically prescribed in the Indenture) may be deemed to be conclusively proved and established by a certificate signed by an Authorized Officer of the Commission, and such certificate will be full warrant for any action taken or suffered in good faith under the provisions of the Trust Indenture in which said Fiduciary has accepted said trust upon the faith thereof, but in its discretion the Fiduciary may in lieu thereof accept other evidence of such fact or matter or may require such further or additional evidence as to it may deem reasonable. Except as otherwise expressly provided in the Indenture, any request, order, notice or other direction required or permitted to be furnished pursuant to any provision of the Indenture by the Commission to any Fiduciary is required to be sufficiently executed if executed in the name of the Commission by an Authorized Officer of the Commission. (Section 10.04)

Permitted Acts and Functions. The Trustee and any Paying Agent may become the owner of any Note, with the same rights it would have if it were not such Fiduciary. Any Fiduciary may act as depository for, and permit any of its officers or directors to act as a member of, or in any other capacity with respect to, any committee formed to protect the rights of Holders or to effect or aid in any reorganization growing out of the enforcement of the Notes or the Indenture, whether or not any such committee is required to represent the Holders of a majority in principal amount of the Notes then outstanding. (Section 10.06)

Resignation of Trustee. The Trustee may at any time resign and be discharged of the duties and obligations created by the Trust Indenture by giving not less than sixty (60) days' written notice to the Commission and by mailing notice (specifying the date such resignation is to take effect) through regular United States mail, postage prepaid, to each Holder of Notes, and such resignation will take effect upon the day specified in such notice unless (i) no successor has been appointed as proved in the Indenture, or (ii) previously a successor shall have been appointed, as provided in the Indenture, in which event such resignation will take effect immediately on the appointment of such successor. If a successor trustee is not appointed within 60 days, the Trustee will be entitled to petition a court of competent jurisdiction to appoint a successor Trustee. (Section 10.07)

Removal of Trustee. The Trustee may and, if at any time so requested by an instrument or concurrent instruments in writing, filed with the Trustee and the Commission, and signed by the Holders of a majority in principal amount of the Notes then Outstanding or their attorneys-in-fact duly authorized, excluding any Notes held by or for the account of the Commission, are require to be removed by the Commission (so long as no Event of Default has occurred and is continuing) by an instrument or concurrent instruments in writing, filed with the Trustee and the Commission and signed by the Commission or the Holders of Notes, as appropriate. No such removal will be effective until a successor Trustee has been appointed and assumed the duties of Trustee as provided in the Indenture. (Section 10.08)

Appointment of Successor Trustee. In case at any time the Trustee shall resign or shall be removed or shall become incapable of acting, or shall be adjudged bankrupt or insolvent, or if a receiver, liquidator or conservator of the Trustee, or of its property, shall be appointed, or if any public officer shall take charge or control of the Trustee, or of its property or affairs, the Commission covenants and agrees that it will thereupon appoint a successor Trustee. The Commission is required to provide notice of any such appointment made by it within twenty (20) days after such appointment to Holders of Notes.

If no appointment of a successor Trustee shall be made pursuant to the foregoing provisions within forty-five (45) days after the Trustee shall have given to the Commission written, as provided in above, or after a vacancy in the office of the Trustee shall have occurred by reason of its removal or inability to act, the Trustee or the Holder of any Note may apply to any court of competent jurisdiction to appoint a successor Trustee. Said court may thereupon, after such notice, if any, as such court any deem proper and prescribe, appoint a successor Trustee.

Any Trustee appointed in succession to the Trustee is required to be a trust company or bank having the powers of a trust company within or outside the Commonwealth, having a capital and surplus aggregating at least Seventy-Five Million Dollars ($75,000,000) if there be such a trust company or bank willing and able to accept the office on reasonable and customary terms and authorized by law to perform all duties imposed upon it by the Indenture. (Section 10.09)

Defeasance. Notes or interest installments of particular Notes for the payment or redemption of which moneys will have been set aside and shall be held in trust by Fiduciaries will, at the maturity or date of redemption thereof, be deemed to have been paid within the meaning and with the effect expressed above. Particular Notes will, prior to the maturity or redemption thereof, be deemed to have been paid within the meaning and with the effect expressed above, if (a) in case any of said Notes are to be redeemed on any date prior to their maturity, the Commission will have given to the Trustee in form satisfactory to it irrevocable instructions to provide notice of redemption in the manner prescribed in the Indenture, (b) there will have been deposited with the Trustee either moneys in an amount which shall be sufficient, or Defeasance Obligations, the principal of and the interest on which when due will provide moneys which, together with the moneys, if any, deposited with the Trustee at the same time, will be sufficient, to pay when due the principal and interest due and to become due on said Notes on and prior to the Redemption or maturity date thereof, as the case may be, (c) in the event said Notes are not subject to redemption within the next 60 days, the Commission will have given the Trustee in form satisfactory to it irrevocable instructions to notify the Holders of such Notes of such redemption in the manner herein provided for giving notice of redemption and (d) a Counsel's Opinion that the defeasance will not adversely affect the exclusion from gross income for federal income tax purposes of interest on the Notes. Neither Defeasance Obligations or moneys deposited with the Trustee as described in this paragraph, nor principal or interest payments on any such obligations, may be withdrawn or used for any purpose other than, and must be held in trust for, the payment of the principal and interest on said Notes.

Anything in the Indenture to the contrary notwithstanding, any moneys held by a Fiduciary in trust for the payment and discharge of any of the Notes which remain unclaimed for six (6) years after the date when all of the Notes have become due and payable, either at their stated maturity dates or by call for earlier redemption, if such moneys were held by the Fiduciary at such date, or for six (6) years after the date of deposit of such moneys if deposited with the Fiduciary after said date when all of the Notes became due and payable, will (subject to the provisions of Article V of the Indenture), at the written request of the Commission, be repaid by the Fiduciary to the Commission, as its absolute property and free from trust, and the Fiduciary will thereupon be released and discharged.

"Defeasance Obligations" means and includes any of the following:

(1) Direct and general non-callable obligations of the United States of America, backed by the full faith and credit of the United States of America or obligations that are unconditionally guaranteed as to principal and interest by the United States of America. The obligations described in this paragraph are called "United States Obligations".

(2) Prerefunded municipal obligations rated "AAA" by each Rating Service then rating the Notes and meeting the following conditions:

(a) the municipal obligations are (i) not to be redeemed prior to maturity or the Trustee has been given irrevocable instructions concerning their calling and redemption and (ii) the issuer has covenanted not to redeem such municipal obligations other than as set forth in such instructions;

(b) the municipal obligations are secured by cash or United States Obligations that may be applied only to interest, principal, and premium payments of such municipal obligations;

(c) the principal of and interest on the United States Obligations (plus any cash in the escrow fund) are sufficient to meet the liabilities on the municipal obligations;

(d) the United States Obligations serving as security for the municipal obligations are held by an escrow agent or trustee;

(e) the United States Obligations (plus any cash in the escrow fund) are not available to satisfy any other claims, including those against the trustee or escrow agent; and

if the redemption date for the Notes to be discharged by the deposit of Defeasance Obligations is no later than ninety (90) days from the date of such deposit, "Defeasance Obligations" shall also include direct and general non-callable obligations of any Federally sponsored enterprise, including Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Federal Farm Credit Banks, Federal Intermediate Credit Banks, Federal Land Banks, Federal Home Loan Banks, Bank for Cooperatives and any other similar institution. (Section 11.01)

**The Financing Agreement**

The Commission, the Cabinet and the University have entered into the Financing Agreement which provides for (i) financing of the Project by issuance of the Notes by the Commission; and (ii) the leasing of the Project from the Commission to the University to provide revenues for amortization of the Notes. As required by the Act, the Cabinet is also a party to the Financing Agreement.

Financing Payments. The Commission has agreed to provide financing for the Project to the University. The University has the right to continue the Financing Agreement until the final maturity date for the Notes. The University is required to pay, as Financing Payments, the Debt Servicing Obligation relating to the Notes so long as any Notes are Outstanding.

Additional Payments. The University covenants and agrees to pay "Additional Payments" for the term of the Financing Agreement and for any Renewal Term during which Notes are outstanding, as follows:

(1) To the Trustee, when due, all fees of the Trustee for services rendered, all fees and charges of any Paying Agent, Registrar, counsel, accountants, and others incurred in the performance on request of the Trustee of services for which the Trustee and such other persons are entitled to payment or reimbursement which are not paid as Financing Payments; and

(2) To the Commission, upon demand, all reasonable expenses incurred by it in relation to the Project which are not otherwise specifically identified and required to be paid by the Commission under the terms of the Financing Agreement.

Financing Agreement an Obligation. The University has authorized and entered into the Trust Agreement. It is the intent of the University that the Financing Agreement constitute an Obligation within the meaning of the Trust Agreement, it is declared that the Financing Agreement is issued and delivered by the University in accordance with the terms of the Trust Agreement, and the Commission is granted all rights and privileges as Holder, as defined in the Trust Agreement, with respect to the Obligation (being the Financing Agreement), for all purposes under the Trust Agreement, subject to the terms of the Trust Agreement.

Events of Default. Each of the following events constitute an "event of default":

(1) default in the due and punctual payment of any Financing Payments or Additional Payments; or

(2) default in the performance of any of the covenants, terms, and conditions of the Financing Agreement, and failure to remedy such default within thirty (30) days after written receipt thereof if the default relates to matters other than the payment of Financing Payments or Additional Payments (but the University will not be deemed to be in default if the University commences to remedy said defaults other than related to payment of Financing Payments or

Additional Payments within said thirty (30) day period, and proceed to and do remedy said default with due diligence).

If an event of default occurs, the Commission, in addition to all other remedies given to the Commission at law or in equity, may by written notice to the University terminate the Financing Agreement. No termination of the Financing Agreement will deprive the Commission of any of its remedies or actions against the University.

Provisions of the Financing Agreement Benefit of the Holders of the Notes. All of the provisions contained in the Financing Agreement, are made for the benefit of each of the holders of the Notes. Each and all of the holders of the Notes, and the Trustee on behalf of the holders of the Notes, have the rights of third party beneficiaries to enforce all of the provisions of the Financing Agreement; subject, however, to the provisions of the Indenture with respect to enforcement of rights.

Security and Assignment. The Financing Agreement secures (i) the payment of Financing Payments and Additional Payments, and (ii) the payment of the Notes in the aggregate principal amount which may from time to time be outstanding under the Indenture, with interest thereon at the rates per annum borne by such Notes.

The Financing Agreement is given subject to all of the terms, conditions and provisions of the Indenture. In the event that any conflict should exist or appear to exist between the provisions of the Financing Agreement and the Indenture, the provisions of the Indenture will prevail. (Section 14.01)

Amendment. The Financing Agreement may be amended or supplemented from time to time by a writing duly executed by the parties thereto; subject, however, to the condition that any such amendment or supplement will be consistent with the terms and conditions of the Indenture and not diminish the Financing Payments or Additional Payments payable under the provisions of the Financing Agreement for so long as any Notes are Outstanding.

## TAX TREATMENT

### General

In the opinion of Bond Counsel for the Notes, based upon an analysis of existing laws, regulations, rulings and court decisions, interest on the Notes is excludable from gross income for Federal income tax purposes and interest on the Notes is not a specific item of tax preference under Section 57 of the Internal Revenue Code of 1986 (the "Code") for purposes of the Federal individual or corporate alternative minimum taxes.

A copy of the opinion of Bond Counsel for the Notes is set forth in "EXHIBIT E," attached hereto.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for Federal income tax purposes of interest on obligations such as the Notes. The Commission has covenanted to comply with certain restrictions designed to ensure that interest on the Notes will not be includable in gross income for Federal income tax purposes. Failure to comply with these covenants could result in interest on the Notes being includable in gross income for Federal income tax purposes and such inclusion could be required retroactively to the date of issuance of the Notes. The opinion of Bond Counsel assumes compliance with these covenants. However, Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) after the date of issuance of the Notes may adversely affect the tax status of the interest on the Notes.

Certain requirements and procedures contained or referred to the Indenture and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Notes) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. Bond Counsel expresses no opinion as to any Notes or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of bond counsel other than Peck, Shaffer & Williams LLP.

Although Bond Counsel for the Notes has rendered an opinion that interest on the Notes is excludable from gross income for Federal income tax purposes and that interest on all Notes is excludable from gross income for Kentucky income tax purposes, the ownership or disposition of, or the accrual or receipt of interest on, the Notes may otherwise affect a Bondholder's Federal, state or local tax liabilities. The nature and extent of these other tax consequences may depend upon the particular tax status of the Bondholder or the Bondholder's other items of income or deduction. Bond Counsel expresses no opinions regarding any tax consequences other than what is set forth in its opinion and each Bondholder or potential Bondholder is urged to consult with tax counsel with respect to the effects of purchasing, holding or disposing the Notes on the tax liabilities of the individual or entity.

For example, corporations are required to include all tax-exempt interest in determining "adjusted current earnings" under Section 56(c) of the Code, which may increase the amount of any alternative minimum tax owed. Similarly, tax-exempt interest may also increase the amount of any environmental tax owed under Section 59 of the Code, which is based on the alternative minimum taxable income of any corporation subject to that tax. Ownership or disposition of the Notes may result in other collateral Federal, state or local tax consequence for certain taxpayers, including, without limitation, increasing the federal tax liability of certain foreign corporations subject to the branch profits tax imposed by Section 884 of the Code, increasing the federal tax liability of certain insurance companies, under Section 832 of the Code, increasing the federal tax liability and affecting the status of certain S Corporations subject to Sections 1362 and 1375 of the Code, and increasing the federal tax liability of certain individual recipients of social security or Railroad Retirement benefits, under Section 86 of the Code. Ownership of any Notes may also result in the limitation of interest and certain other deductions for financial institutions and certain other taxpayers, pursuant to Section 265 of the Code. Finally, residence of the holder of Notes in a state other than Kentucky or being subject to tax in a state other than Kentucky, may result in income or other tax liabilities being imposed by such states or their political subdivisions based on the interest or other income from the Notes.

The Commission has not designated the Notes as "qualified tax-exempt obligations" under Section 265 of the Code.

**Premium**

"Acquisition Premium" is the excess of the cost of a bond over the stated redemption price of such bond at maturity or, for bonds that have one or more earlier call dates, the amount payable at the next earliest call date. The Notes that have an interest rate that is greater than the yield, as shown on the cover page hereto (the "Premium Notes"), are being initially offered and sold to the public at an Acquisition Premium. For federal income tax purposes, the amount of Acquisition Premium on each bond the interest on which is excludable from gross income for federal income tax purposes ("tax-exempt bonds") must be amortized and will reduce the holder's adjusted basis in that bond. However, no amount of amortized Acquisition Premium on tax-exempt bonds may be deducted in determining holder's taxable income for federal income tax purposes. The amount of any Acquisition Premium paid on the Premium Notes, or on any of the Notes, that must be amortized during any period will be based on the "constant yield" method, using the original holder's basis in such bonds and compounding semiannually. This amount is amortized ratably over that semiannual period on a daily basis.

Holders of any Notes, including any Premium Notes, purchased at an Acquisition Premium should consult their own tax advisors as to the actual effect of such Acquisition Premium with respect to their own tax situation and as to the treatment of Acquisition Premium for state tax purposes.

**Original Issue Discount**

The Notes that have an interest rate that is lower than the yield, as shown on the cover page hereto (the "Discount Notes"), are being offered and sold to the public at an original issue discount ("OID") from the amounts payable at maturity thereon. OID is the excess of the stated redemption price of a bond at maturity (the face amount) over the "issue price" of such bond. The issue price is the initial offering price to the public (other than to bond houses, brokers or similar persons acting in the capacity of underwriters or wholesalers) at which a substantial amount of bonds of the same maturity are sold pursuant to that initial offering. For federal income tax purposes, OID on each bond will accrue over the term of the bond, and for the Discount Notes, the amount of accretion will be based on a single rate of interest, compounded semiannually (the "yield to maturity"). The amount of OID that accrues during each semi-annual period will do so ratably over that period on a daily basis. With respect to an initial purchaser of a Discount Note at its issue price, the portion of OID that accrues during the period that such purchaser owns the Discount Note is added to such purchaser's tax basis for purposes of determining gain or loss at the maturity, redemption, sale or other disposition of that Discount Note and thus, in practical effect, is treated as stated interest, which is excludable from gross income for federal income tax purposes.

Holders of Discount Notes should consult their own tax advisors as to the treatment of OID and the tax consequences of the purchase of such Discount Notes other than at the issue price during the initial public offering and as to the treatment of OID for state tax purposes.

## LITIGATION

There is no controversy or litigation of any nature now pending or threatened restraining or enjoining the issuance, sale, execution or delivery of the Notes, or in any way contesting or affecting the validity of the Notes or any proceedings of the Commission taken with respect to the issuance or sale thereof, or the pledge or application of any monies or security provided for the payment of the Notes or due existence or powers of the Commission.

## APPROVAL OF LEGALITY

Certain legal matters incident to the authorization, issuance, sale and delivery of the Notes are subject to the unqualified approving opinion of Peck, Shaffer & Williams LLP, Covington, Kentucky, Bond Counsel to the Commission. Certain other legal matters will be passed on by Thompson Hine LLP, Cincinnati, Ohio, counsel to the Underwriter.

## RATINGS

Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Ratings Services, a Division of The McGraw-Hill Companies, Inc. ("S&P") have given the Notes the ratings of "Aaa" and "AAA", respectively, each with the understanding that upon delivery of the Notes, the Bond Insurance Policy will be issued by the Bond Insurer. The underlying ratings for the Bonds are "Aa3" and "AA-" from Moody's and, S&P, respectively. Each rating reflects only the views of the respective Rating Agency. Explanations of the significance of the ratings may be obtained from each Rating Agency as follows: Moody's Investors Service, Inc., 99 Church Street, New York, New York 10007, (212) 553-0300; and Standard & Poor's Ratings Services, a Division of the McGraw-Hill Companies, 55 Water Street, New York, New York 10041 (212) 438-2124. A rating is a not recommendation to buy, sell or hold the Notes, and there is no assurance that any rating will be maintained for any given period of time by a Rating Agency or that it will not be revised or withdrawn entirely by such Rating Agency, if in its judgment circumstances so warrant. Any such revision or withdrawal of a rating may have an adverse affect on the market price of the Notes.

## CONTINUING DISCLOSURE

The Commission will comply with the requirements of the Securities and Exchange Commission regarding secondary market disclosure as set forth in Rule 15c2-12 (the "Rule"), as amended, under the Securities Exchange Act of 1934. Specifically, the Commission will enter into a Continuing Disclosure Agreement in which it will covenant to provide notice in a timely manner to each nationally recognized municipal securities depository or the Municipal Securities Rulemaking Board, and the appropriate state information depository, if any, of any of the following types of events with respect to the Notes, if material: (i) principal and interest payment delinquencies; (ii) non-payment related defaults; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers or their failure to perform; (vi) adverse tax opinions or events affecting the tax-exempt status of the securities; (vii) modifications to rights of security holders; (viii) bond calls; (ix) defeasances; (x) release, substitution, or sale or property securing repayment of the securities; and (xi) rating changes. The Commonwealth is already providing ongoing market disclosure as required by Rule 15c2-12 pursuant to agreements entered into in connection with other outstanding securities.

## UNDERWRITING

Morgan Stanley & Co. Incorporated, as representative of the underwriters set forth on the cover page hereof (the "Underwriters"), has agreed to purchase the Notes for a purchase price of $109,239,396.70, which is an amount equal to the par amount of the Notes, plus net premium of $2,267,345.55, less Underwriters' discount of $567,948.85. The Underwriters are committed to purchase all of the Notes if any are purchased.

The Underwriters have advised the Commission that they intend to make a public offering of the Notes at the initial public offering prices or yields set forth on the cover page hereof; provided, however, that the Underwriters have reserved the right to make concessions to dealers and to change such initial public offering prices as the Underwriters deem necessary in connection with the marketing of the Notes.

## MISCELLANEOUS

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between the Commission and the purchasers or Holders of any of the Notes.

**KENTUCKY ASSET/LIABILITY COMMISSION**

By: /s/ R. B. Rudolph, Jr.
R. B. Rudolph, Jr., Chairman

By: /s/ F. Thomas Howard
F. Thomas Howard, Secretary

**EXHIBIT A**

**INFORMATION PERTAINING TO THE UNIVERSITY OF KENTUCKY**

## General

Located in Lexington, the University of Kentucky is the Commonwealth of Kentucky's flagship institution of higher education. As a land grant institution, the University is dedicated to enriching people's lives through excellence in teaching, research and service and plays a critical leadership role for the state by promoting human and economic development that improves lives within Kentucky's borders and beyond.

The University has a presence in all 120 counties – through its Agricultural Extension Service—with an impact nationwide and abroad. Total enrollment is nearly 27,000 students, representing all Kentucky counties, every state in the nation, and 117 countries. In 2004 - 2005, the University conferred 6,272 degrees among its comprehensive academic programs. About 1,900 full-time faculty and 9,000 full-time staff are employed by the University.

The University consists of 16 colleges, plus the Graduate School. With 93 undergraduate programs, master's degrees in 99 fields, doctoral degrees in 66 programs, and four professional programs, the colleges include: Agriculture, Arts and Sciences, Business and Economics, Communications and Information Studies, Dentistry, Design, Education, Engineering, Fine Arts, Health Sciences, Law, Medicine, Nursing, Pharmacy, Public Health, and Social Work. The University boasts more than 80 national rankings for academic excellence.

The University's William T. Young Library is among the world's leading research libraries; its book endowment is the largest among public universities and ranks second only to Harvard University among all universities. Its broad scope of technology offers students, faculty and Kentucky residents access to the most up-to-date information from online journals, government publications, and private studies, as well as more traditional materials.

The UK Chandler Medical Center, which opened in 1960, is considered one of the nation's finest academic medical centers. The faculty, students and staff take pride in achieving excellence in education, patient care, research, and community service. As one of two Level 1 Trauma Centers in the state and the first health-care facility in Central and Eastern Kentucky to obtain distinction as a Primary Stroke Center, UK Chandler Medical Center cares for the most critically injured and ill patients in the region. The 473-bed UK Chandler Medical Center and UK Children's Hospital (together, the "Hospital) are supported by more than 500 faculty physicians and dentists, 400 resident physicians, and a staff of 3,200 health professionals committed to high-quality patient care.

Research at the University is a dynamic enterprise encompassing both traditional scholarship and emerging technologies. The Advanced Science and Technology Commercialization Center, for example, is a hub for multidisciplinary research collaboration. It is just one of more than 50 research centers and institutes across campus, including the highly acclaimed Sanders-Brown Center on Aging, Morris K. Udall Parkinson's Disease Research Center of Excellence, and Markey Cancer Center, where University researchers are discovering and developing new treatments to improve health care, providing a rich training ground for the next generation of researchers, and advancing the state's economic growth.

During fiscal year 2005, the University faculty received a record-breaking total of $274.0 million in extramural funding for grants and contracts. The achievement marked an increase of 15 percent from last fiscal year and the fourth year in a row the University exceeded the $200 million level in sponsored project awards.

The majority of grants and contracts – 56 percent – were awarded by federal agencies and totaled \$152.2 million, an increase of 6 percent over the prior year. Due to the University's improvement – from $31^{st}$ to $28^{th}$ among public research institutions – in the National Science Foundation's most recent rankings of federal spending obligations, the Commonwealth of Kentucky is now ranked $30^{th}$, up from $33^{rd}$.

The University is committed to strong public service, reaching out to communities across the Commonwealth, sharing knowledge and making a difference in the towns, cities, and lives of all Kentuckians. An example is Health Education through Extension Leadership, a partnership between the College of Public Health, the College of Dentistry, the College of Agriculture, and the Cooperative Extension Service to enhance extension agents' capacity to deliver valuable health and wellness information throughout the state.

The University's agenda is simple – to be a catalyst for a new Commonwealth, one that is healthier, more prosperous and economically secure and that educates the state's best and brightest. The University is accelerating the movement toward academic excellence, becoming known worldwide for the quality of its academic programs, its commitment to undergraduates, its success in building a diverse community, and its engagement with the larger society.

NOTE: Effective January 14, 1998, the Board of Trustees pursuant to the direction of the General Assembly (The Kentucky Postsecondary Education Improvement Act of 1997) delegated to the Board of Regents of the Kentucky Community and Technical College System (KCTCS), the management responsibilities for the University of Kentucky Community College System (UKCC) except for the Lexington Community College. This delegation of management responsibilities to KCTCS includes management of facilities and grounds, assets, liabilities, revenues, personnel, programs, financial and accounting services and support services. Governmental Accounting and Financial Reporting Standards provide that the financial operations of the UKCC no longer be included in the University financial reports as of July 1, 1997. Therefore, in general, statistical information in this Official Statement does not include Community Colleges (other than Lexington Community College) for the fiscal years after 1996-97.

Effective July 1, 2004, the Board of Trustees, pursuant to the direction of the Kentucky General Assembly, delegated to the Board of Regents of KCTCS the management of Lexington Community College. Therefore, in general, statistical information in this Official Statement does not include Lexington Community College for the fiscal years after 2003-04.

**Governing Board**

The Governing Body of the University is the Board of Trustees (the "Board") consisting of twenty members, sixteen appointed by the Governor of the Commonwealth of Kentucky; two faculty members elected by the faculty; one student member, who is the President of the student body, or if he or she is not a full-time student who maintains permanent residence in the Commonwealth, a full-time student who does maintain permanent residency in the Commonwealth elected by the student body; and one member of the University staff. Pursuant to Section 164.160 of the Kentucky Revised Statutes, the Board is a body corporate with the powers usually vested in corporations and, as such, subject to the statutes of the Commonwealth, has control and management of the University, together with the properties and funds thereof.

**Administrative Officers**

The President of the University is Dr. Lee T. Todd, Jr.; the Acting Provost is M. Scott Smith; the Executive Vice President for Finance and Administration is Frank Butler; the Executive Vice President for Research is Wendy Baldwin; the Executive Vice President for Health Affairs is Dr. Michael Karpf; and the Treasurer of the University is Henry Clay Owen.

## FISCAL YEAR 2005-06 BUDGET

The 2005-06 fiscal year budget for the University is $1,664,857,600, an increase of $178,843,200 from the final fiscal year 2004-2005 budget.

## OPERATIONS

### Summary of Revenues, Expenses and Changes in Net Assets

The following is a summary of the University's revenues, expenses and changes in net assets for the most recent three year period available:

| | Year Ended June 30 (Audited) (Dollars in Thousands) | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| Operating revenue | $966,874 | $1,060,909 | $1,186,978 |
| Operating expenses | 1,297,330 | 1,383,699 | 1,468,205 |
| Operating loss | (330,456) | (322,790) | (281,227) |
| Non-operating revenue, including state appropriations | 395,779 | 423,111 | 405,906 |
| Increase in net assets | $65,323 | $100,321 | $124,679 |

### Enrollment

The following schedule indicates the Fall Semester head count and full-time equivalent enrollment at the University for each of the academic years 1996-97 through 2005-06. The full-time enrollment calculation is made in accordance with the method used by the United States Department of Education.

| | Community College | | Main Campus | | Total | |
|---|---|---|---|---|---|---|
| Academic Year[1] | Head Count[3] | Full-Time Equivalent[2,3] | Head Count | Full-Time Equivalent[2] | Head Count | Full-Time Equivalent[2] |
| 1996-97 | 43,674 | 25,202 | 24,061 | 20,224 | 67,735 | 45,426 |
| 1997-98 | 5,558 | 3,658 | 24,171 | 20,307 | 29,729 | 23,965 |
| 1998-99 | 6,118 | 4,035 | 24,394 | 20,729 | 30,512 | 24,764 |
| 1999-00 | 6,807 | 4,461 | 23,742 | 20,128 | 30,549 | 24,589 |
| 2000-01 | 7,150 | 4,685 | 23,816 | 20,150 | 30,966 | 24,835 |
| 2001-02 | 7,793 | 5,871 | 23,901 | 20,878 | 31,694 | 26,749 |
| 2002-03 | 8,270 | 6,251 | 24,985 | 21,872 | 33,255 | 28,122 |
| 2003-04 | 8,672 | 6,517 | 25,398 | 22,310 | 34,070 | 28,827 |
| 2004-05 | N/A | N/A | 26,545 | 22,604 | 26,545 | 22,604 |
| 2005-06[4] | N/A | N/A | 26,835[4] | 23,088[4] | 26,835[4] | 23,088[4] |

[1] Enrollment does not include the Community Colleges after 1996-1997 except for Lexington Community College.
[2] Full-time and part-time enrollment equated to full-time enrollment.
[3] As of June 30, 2004, Lexington Community College is part of KCTCS.
[4] Preliminary.

In reviewing enrollment projections, consideration has been given to planning for adequate academic and housing accommodations for future enrollments. The programs will be developed so that academic and housing facilities will not be limiting factors on the enrollment growth projected. The enrollment projection for the University is set forth in the following tabulations:

| Academic Year | Main Campus Fall Semester Student Enrollment (Full-Time Equivalent)[1] |
|---|---|
| 2006-2007 | 23,100 |
| 2007-2008 | 23,150 |
| 2008-2009 | 23,200 |
| 2009-2010 | 23,250 |
| 2010-2011 | 23,300 |

[1] Projections based on 2005-2006 data

Approximately 20.5% of the students enrolled in the University are non-residents of Kentucky and it is anticipated that the percentage of non-resident enrollments will remain at this level in future years.

**Admissions Information – Fall Semester**
**Undergraduate Admissions**

The following is a summary of certain undergraduate admission information for the most recent five year period available:

| | **2001** | **2002** | **2003** | **2004** | **2005[1]** |
|---|---|---|---|---|---|
| Number of Applications | 8,449 | 8,879 | 9,418 | 10,604 | 10,515 |
| Number Approved for Enrollment | 6,914 | 7,250 | 7,603 | 8,353 | 8,123 |
| Number Enrolled | 3,037 | 3,718 | 3,688 | 3,961 | 3,844 |
| Average ACT Scores (First time full-time Freshman) | 24.3 | 24.03 | 24.5 | 24.2 | 24.745 |

[1] Preliminary

[The remainder of this page is intentionally left blank.]

**State Appropriations**

The following is a summary of the University's General Fund state appropriations for the most recent ten year period available:

| Year | Appropriation |
|---|---|
| 1996-97 | $345,937,000 |
| 1997-98 | 278,934,000 [1] |
| 1998-99 | 286,475,000 [1] |
| 1999-00 | 290,640,000 [1] |
| 2000-01 | 307,821,000 [1] |
| 2001-02 | 303,639,000 [1] |
| 2002-03 | 304,735,000 [1] |
| 2003-04 | 302,539,000 [1] |
| 2004-05 | 295,807,600 [2, 3] |
| 2005-06 | 314,302,600 [3, 4] |

[1] Does not include the Community Colleges appropriations except for Lexington Community College.
[2] Includes $7,749,500 in fiscal year 2004-05 for debt service.
[3] Does not include the Community Colleges appropriations except for Lexington Community College debt service appropriation.
[4] Includes $7,960,400 in fiscal year 2005-06 for debt service.

The amount of funds appropriated has been based in part on the debt service on the University's outstanding Consolidated Educational Buildings Revenue Bonds. The amounts set forth above, except for 2005-06, are amounts actually received, which, in certain years, have been less than amounts included in the original state budget for that year. The Board presently intends, but is not obligated, to continue to seek to have funds appropriated by the General Assembly to partially support the operations of the University. THE GENERAL ASSEMBLY IS NOT NOW OBLIGATED, NOR WILL THERE BE AN OBLIGATION IN THE FUTURE TO MAKE APPROPRIATIONS TO THE UNIVERSITY. IN ADDITION, THERE CAN BE NO ASSURANCE THAT IN THE PERFORMANCE OF HIS OR HER OBLIGATION TO BALANCE THE STATE BUDGET ANNUALLY, THE GOVERNOR WILL NOT REDUCE OR ELIMINATE ANY APPROPRIATIONS WHICH ARE MADE.

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### Grants and Contracts

The following is a summary of the University's grant and contract amounts for the most recent ten year period available:

| Year | Amount |
|---|---|
| 1995-96 | $109,320,906 |
| 1996-97 | 114,686,921 |
| 1997-98 | 119,852,159 |
| 1998-99 | 124,819,725 [1] |
| 1999-00 | 128,116,917 [1] |
| 2000-01 | 146,914,931 [1] |
| 2001-02 | 170,378,424 [1] |
| 2002-03 | 197,651,327 [1] |
| 2003-04 | 218,890,770 [1] |
| 2004-05 | 250,381,051 [1] |

[1] Does not include Community Colleges Student Financial Aid except for Lexington Community College.

### Student Financial Aid

The following is a summary of the University's student financial aid for the most recent ten year period available:

| Year | Amount |
|---|---|
| 1995-96 | $134,287,110 |
| 1996-97 | 139,075,157 |
| 1997-98 | 146,673,202 |
| 1998-99 | 108,902,995 [1] |
| 1999-00 | 110,992,616 [1] |
| 2000-01 | 129,340,356 [1] |
| 2001-02 | 139,411,538 [1] |
| 2002-03 | 167,461,348 [1] |
| 2003-04 | 184,255,947 [1] |
| 2004-05 | 171,972,107 [2] |

[1] Does not include Community Colleges Student Financial Aid except for Lexington Community College.
[2] Does not include Community Colleges Student Financial Aid <u>or</u> Lexington Community College.

**Comparative Report of Student Financial Aid**

The following is a comparative summary of the University's student financial aid for the most recent two year period available:

| | 2003-2004 | 2004-2005 |
|---|---|---|
| **Scholarships & Grants** | $37,793,675 | $35,212,154 |
| **Federal Grants** | | |
| Pell | 16,713,069 | 9,564,371 |
| Supplemental Educational Opportunity Grant (SEOG) | 1,199,054 | 1,114,501 |
| **College Work Study** | 1,173,644 | 1,150,954 |
| **Financial Aid from Outside Agencies** | | |
| Federal Grants (FAFSA) | 1,518,595 | 1,060,162 |
| State Grants | 20,640,500 | 19,459,771 |
| Agency Scholarships | 8,299,018 | 9,096,170 |
| **Loans** | | |
| National Direct Student Loans (Perkins) | 5,649,021 | 3,567,381 |
| Health Professions | 449,296 | 544,720 |
| Guaranteed Student Loans – Outside Agencies | 90,231,467 | 84,663,694 |
| **Other** | 588,608 | 6,538,229 |
| **Total Program Expenditures** | $184,255,947 | $171,972,107 |

**The University of Kentucky Hospital**

History and Background. The Hospital is an organizational unit of the University. It holds a position of leadership as a statewide, regional, and national tertiary referral hospital. Initial funds for the University Hospital were appropriated by the 1956 General Assembly, and the first patients were admitted to the University Hospital in 1962.

In its commitment to quality care, the Hospital and the Hospital's medical staff representing all medical and surgical specialties, provides a full scope of services, such as extensive pediatric services offering sophisticated neonatal intensive care, renal, bone marrow and solid organ transplant programs, and comprehensive high-risk obstetrical services. The Hospital and its staff are leaders in developing and refining new technology including imaging and comprehensive medical, surgical, cancer, geriatric, cardiac, and burn specialty programs. Patients benefiting from these services come from all of Kentucky's counties, contiguous states, other states, and many foreign countries.

Relationship to Other Units of the Medical Center. Within the Albert B. Chandler Medical Center, along with the Hospital, there are the Colleges of Medicine, Nursing, Dentistry, Pharmacy, Public Health, and Health Sciences.

In its support of the Medical College, the Hospital provides a facility for teaching and research. The medical college annually graduates approximately 95 physicians and supervises the clinical experience of 490 post-graduate physicians each year. The facilities at the medical school adjoin the Hospital containing lecture halls, classroom space, offices, and laboratories.

The primary function of the College of Medicine is the education of physicians through a four-year doctor of medicine degree (M.D.) program and three to seven year residency programs which are offered in 29 medical and surgical subspecialties. In addition, masters (M.S.), doctoral (PhD), and post-doctoral programs are offered in five basic science areas. The College of Medicine also operates the Sanders Brown Research Center on Aging, which is among the nation's leaders in Alzheimer's disease research. The Center is engaged in the multi-disciplinary study of the problems of aging. Both inpatient hospital and ambulatory patient care services are provided by the faculty of the College of Medicine within the Medical Center, as well as a number of clinical practice settings principally in Eastern Kentucky in conjunction with the University's four Area Health Education Center Affiliations in Berea, Hazard, Williamstown and Morehead.

The other colleges within the Medical Center, Nursing, Dentistry, Pharmacy, Public Health, and Health Sciences also use the University Hospital as a prime teaching site for students and residents and patient care facility to carry out their mission of research and education.

Hospital Mission, Vision And Critical Success Factors. The Hospital recognizes the need for organizational planning to maintain its position as a quality health care provider. The Hospital's mission is to help people of the Commonwealth and beyond gain and retain good health through creative leadership and quality initiatives in patient care, education and research. To achieve this Mission the Hospital has set a Vision of being a top 20 public academic health center, recognized nationally and internationally for excellence in patient care, education and research.

Hospital Administration. The Executive Vice President for Health Affairs is Michael Karpf; the Vice President for Health Affairs and CFO of the HealthCare Enterprise is Sergio Melgar; the Chief Medical Officer is Richard P. Lofgren, M.D., M.P.H.; the Chief Information Officer for the UK Healthcare Enterprise is Zed E. Day; the Associate Vice President for Medical Center Operations is Murray B. Clark, Jr.; and the Chief Nursing Officer/Associate Hospital Director is Karen Stefaniak, RN, Ph.D.

Hospital Operating Results and Financial Condition.

*Statement of Revenue, Expenses and Changes In Net Assets*. The following summary of the University Hospital's revenue, expenses and changes in net assets for each of the fiscal years ended June 30, 2003, 2004 and 2005 has been derived from audited financial statements. The audited financial statements for the fiscal year ended June 30, 2005, appear in "EXHIBIT B" hereto. This summary should be read in conjunction with the audited financial statements, notes and independent auditor's report.

| | Year Ended June 30 (Audited) (Dollars in Thousands) | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| Operating revenue | $345,142 | $371,982 | $441,935 |
| Operating expenses | 310,636 | 341,323 | 404,777 |
| Operating income | 34,506 | 30,659 | 37,158 |
| Net non-operating revenue (expenses) | 15,987 | (2,985) | 8,502 |
| Net income before other revenues, expenses, gains or losses | 50,493 | 27,674 | 45,660 |
| Transfer to University | (5,179) | (9,478) | (17,305) |
| Net loss from discontinued operations | (242) | (109) | (40) |
| Increase in net assets | $45,072 | $18,087 | $28,315 |

*Certain Operating Information.*

| | Fiscal Year Ended June 30 | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| Average Licensed Beds | 473 | 473 | 473 |
| Available Beds | 415 | 406 | 436 |
| Patient Days | 110,900 | 112,575 | 122,704 |
| Patient Days Equivalents* | 176,358 | 172,046 | 191,892 |
| Admissions | 19,071 | 19,677 | 22,312 |
| Discharges | 19,102 | 19,644 | 22,269 |
| Average Length of Stay (days) | 5.80 | 5.72 | 5.51 |
| Occupancy | 73.21% | 75.37% | 77.13% |
| Emergency Visits | 38,153 | 40,320 | 42,909 |
| Outpatient Visits with Hospital Charge | 245,591 | 246,546 | 266,245 |

*Total patient activity computed by converting outpatient activity to an inpatient equivalent.

## OUTSTANDING BONDS OF THE UNIVERSITY OF KENTUCKY

In addition to the Notes, the University has the following bonds outstanding as of November 1, 2005.

**Consolidated Educational Buildings Revenue Bonds**

| | Year of Issue | Amount of Issue | Amount Outstanding | Year Of Final Maturity |
|---|---|---|---|---|
| Series G, H & I (3rd Series) | 1993 | $27,940,000 | $1,490,000 | 2006 |
| Series M (2nd Series) | 1998 | 4,695,000 | 4,385,000 | 2011 |
| Series N (2nd Series) | 2001 | 18,795,000 | 13,065,000 | 2012 |
| Series K (3rd Series) | 2003 | 5,115,000 | 3,730,000 | 2010 |
| Series S | 2003 | 29,775,000 | 28,715,000 | 2024 |
| Series T | 2003 | 17,635,000 | 16,715,000 | 2023 |
| Series O (2nd Series) | 2003 | 9,335,000 | 8,070,000 | 2015 |
| Series E, J & L (3rd Series) | 2004 | 19,520,000 | 15,515,000 | 2011 |
| Series P, Q & R (2nd Series) | 2004 | 52,110,000 | 49,880,000 | 2021 |
| Series U | 2005 | 11,495,000 | 11,495,000 | 2025 |
| TOTAL | | $196,415,000 | $153,060,000 | |

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**Housing and Dining System Revenue Bonds**

| | Year of Issue | Amount of Issue | Amount Outstanding | Year of Final Maturity |
|---|---|---|---|---|
| Series K | 1978 | $4,584,000 | $2,145,000 | 2018 |
| Series N | 1994 | 4,135,000 | 940,000 | 2008 |
| Series P | 1996 | 2,140,000 | 205,000 | 2007 |
| Series Q | 1997 | 6,645,000 | 520,000 | 2008 |
| Series R | 2000 | 10,450,000 | 10,425,000 | 2020 |
| Series S | 2003 | 52,815,000 | 52,815,000 | 2023 |
| Series M & O (2nd Series) | 2003 | 4,235,000 | 3,830,000 | 2024 |
| Series P & Q (2nd Series) | 2005 | 6,230,000 | 6,175,000 | 2017 |
| **Total** | | $91,234,000 | $77,055,000 | |

**Library Bonds (issued by the Lexington-Fayette Urban County Government)**

| | Year of Issue | Amount of Issue | Amount Outstanding | Year of Final Maturity |
|---|---|---|---|---|
| 1998 Series | 1998 | $43,420,000 | $41,415,000 | 2025 |

Please refer to the financial statements included in "EXHIBIT B" for additional obligations of the University.

**TOTAL ANNUAL DEBT SERVICE REQUIREMENTS**

| Year Ending June 30 | Existing Debt Service | 2005 Series A Bonds Principal | Interest | Total | Total Debt Service |
|---|---|---|---|---|---|
| 2006 | $30,642,295.60 | | | | $30,642,295.60 |
| 2007 | 27,651,121.29 | | | | 27,651,121.29 |
| 2008 | 24,862,811.30 | | $2,403,813.13 | $2,403,813.13 | 27,266,624.43 |
| 2009 | 24,880,217.52 | | 4,807,626.26 | 4,807,626.26 | 29,687,843.78 |
| 2010 | 24,914,976.26 | $4,395,000.00 | 4,735,108.76 | 9,130,108.76 | 34,045,085.02 |
| 2011 | 24,132,608.76 | 4,545,000.00 | 4,585,326.26 | 9,130,326.26 | 33,262,935.02 |
| 2012 | 21,439,281.26 | 4,715,000.00 | 4,415,458.13 | 9,130,458.13 | 30,569,739.39 |
| 2013 | 19,204,572.50 | 4,905,000.00 | 4,227,655.00 | 9,132,655.00 | 28,337,227.50 |
| 2014 | 19,199,390.00 | 5,115,000.00 | 4,014,755.00 | 9,129,755.00 | 28,329,145.00 |
| 2015 | 19,202,215.00 | 5,365,000.00 | 3,765,030.00 | 9,130,030.00 | 28,332,245.00 |
| 2016 | 18,255,340.00 | 5,635,000.00 | 3,498,855.00 | 9,133,855.00 | 27,389,195.00 |
| 2017 | 18,268,345.00 | 5,905,000.00 | 3,224,867.50 | 9,129,867.50 | 27,398,212.50 |
| 2018 | 18,297,135.00 | 6,180,000.00 | 2,953,705.00 | 9,133,705.00 | 27,430,840.00 |
| 2019 | 17,805,360.00 | 6,450,000.00 | 2,682,092.50 | 9,132,092.50 | 26,937,452.50 |
| 2020 | 20,223,075.00 | 6,740,000.00 | 2,393,525.00 | 9,133,525.00 | 29,356,600.00 |
| 2021 | 15,432,012.50 | 7,045,000.00 | 2,088,493.75 | 9,133,493.75 | 24,565,506.25 |
| 2022 | 13,907,820.00 | 7,365,000.00 | 1,767,871.25 | 9,132,871.25 | 23,040,691.25 |
| 2023 | 13,896,600.00 | 7,700,000.00 | 1,430,750.00 | 9,130,750.00 | 23,027,350.00 |
| 2024 | 6,426,450.00 | 8,075,000.00 | 1,055,625.00 | 9,130,625.00 | 15,557,075.00 |
| 2025 | 7,289,800.00 | 8,490,000.00 | 644,212.50 | 9,134,212.50 | 16,424,012.50 |
| 2026 | - | 8,915,000.00 | 217,337.50 | 9,132,337.50 | 9,132,337.50 |
| Total | $385,931,426.99 | $107,540,000.00 | $54,912,107.54 | $162,452,107.54 | $548,383,534.53 |

**PLEDGED REVENUES – GENERAL FUND RECEIPTS**
**UNIVERSITY OF KENTUCKY**
**FISCAL YEAR ENDING JUNE 30, 2005**

| Revenue Type | 2005 Amount (000's) | Pledged (000's) | Prior Pledge Debt Service (000's) | Net General Receipts Pledged Revenues (000's) |
|---|---|---|---|---|
| Student tuition and fees | $133,389 | $133,389 | $19,364 | $114,025 |
| Nongovernmental grants and contracts | 30,113 | 6,880 | - | 6,880 |
| Recoveries of facilities and administrative costs | 40,333 | 40,333 | - | 40,333 |
| Sales and services | 38,857 | 38,191 | - | 38,191 |
| Hospital patient services | 440,609 | 440,609 | - | 440,609 |
| Auxiliary enterprises - housing and dining | 32,142 | 32,142 | 6,314 | 25,828 |
| Auxiliary enterprises - other | 20,699 | 20,699 | - | 20,699 |
| Other operating revenue | 465 | 465 | - | 465 |
| State appropriations | 287,897 | 287,897 | - | 287,897 |
| Gifts and grants | 24,638 | 1,807 | - | 1,807 |
| Investment income | 56,517 | 3,987 | - | 3,987 |
| | $1,105,659 | $1,006,399 | $25,678 | $980,721 |

## SUMMARY OF THE TRUST AGREEMENT

The following is a summary of certain provisions of the Trust Agreement dated as of November 1, 2005, between the University and U.S. Bank National Association, as Trustee. This summary is not to be regarded as a complete statement of the Trust Agreement to which reference is made for a complete statement of the actual terms thereof. Copies of the Trust Agreement are on file with the Trustee.

### Defined Terms

The terms defined below are among those used in the Official Statement and in this summary of the Trust Agreement. Except where otherwise indicated or provided, words in the singular number include the plural as well as the singular number and vice versa.

"Act" means Sections 162.340 to 162.380 of the Kentucky Revised Statutes, Chapter 56 of the Kentucky Revised Statutes and Sections 58.010 to 58.140 of the Kentucky Revised Statutes as the same may be amended, modified, revised, supplemented, or superseded from time to time.

"Additional Obligation Instruments" means agreements providing for the repayment of money that the University may, from time to time, be authorized to enter into under the laws of the Commonwealth. The definition of Additional Obligation Instruments does not include "Bond" or "Bonds," "Note" or "Notes," Financing Agreements or SPBC Leases.

"ALCo" means the Kentucky Asset/Liability Commission and any successor thereto.

"Authenticating Agent" means the Trustee and the Registrar for the series of Obligations and any bank, trust company or other Person designated as an Authenticating Agent for such series of Obligations by or in accordance with the Trust Agreement.

"Beneficial Owner" means, with respect to the Obligations, a Person owning a Beneficial Ownership Interest therein, as evidenced to the satisfaction of the Trustee.

"Beneficial Ownership Interest" means the beneficial right to receive payments and notices with respect to a series of Obligations which are held by a Depository under a Book Entry System.

"Board" means the Board of Trustees of the University, or if there shall be no such Board of Trustees, such Person or body which, pursuant to law or the organizational documents of the University, is vested with the power to direct the management and policies of the University, and shall include any committee empowered to act on behalf of such board or body.

"Bond" or "Bonds" means any bond, or all of the bonds, or an issue or series of bonds, as the case may be, as so identified in the certificate of the Fiscal Officer, of the University issued pursuant to the 2005 General Bond Resolution, a Series Resolution and the Trust Agreement. The definition of Bond and Bonds does not include "Note" or "Notes," Financing Agreements, SPBC Leases or Additional Obligation Instruments.

"Bond Counsel" means an attorney or firm of attorneys of nationally recognized standing on the subject of municipal bonds selected by the University or its counsel and acceptable to the Trustee.

"Book Entry Form" or "Book Entry System" means, with respect to the Obligations, a form or system, as applicable, under which (a) the Beneficial Ownership Interests may be transferred only through a book entry and (b) physical Obligation certificates in fully registered form are registered only in the name of a Depository or its nominee as Holder, with the physical Obligation certificates "immobilized" in the custody of the Depository. The Book Entry System maintained by and the responsibility of the Depository and not maintained by or the responsibility of the University or the Trustee is the record that identifies, and records the transfer of the interests of, the owners of book entry interests in the Obligations.

"Business Day" means a day of the year, other than a Saturday or Sunday, on which banks located in the city in which the principal corporate trust office of the Trustee is located are not required or authorized to remain closed or a day on which The New York Stock Exchange is not closed.

"Certificate of Award" means, with respect to any series of Obligations, the Certificate of Award for such series, if any, authorized in the applicable Series Resolution or the contract of purchase for such series of Obligations.

"Commonwealth" means the Commonwealth of Kentucky.

"Costs of University Facilities" means the costs of or related to University Facilities, and the financing thereof, for the payment of which Obligations may be issued under the Act.

"Credit Support Instrument" means an irrevocable letter of credit, line of credit, standby bond purchase agreement, insurance policy, guaranty or surety bond or similar instrument providing for the payment of or guaranteeing the payment of principal or purchase price of and interest on Obligations when due, either to which the University is a party or which is provided at the request of the University.

"Credit Support Provider" means the provider of a Credit Support Instrument.

"Debt Service Charges" means, generally, for any applicable time period, (i) the principal (including any Mandatory Sinking Fund Requirements), interest and redemption premium, if any, required to be paid by the University on Obligations pursuant to any Series Resolution, less any capitalized interest for such time period and accrued interest on deposit in the Debt Service Payment Account; (ii) any amounts due to a Credit Support Provider to the extent as set forth in a Credit Support

Instrument; and (iii) any amounts due to a Hedge Provider to the extent as set forth in an Interest Rate Hedge Agreement.

"Debt Service Fund" means the Debt Service Fund authorized and created pursuant to the Trust Agreement.

"Debt Service Payment Account" means the Debt Service Payment Account within the Debt Service Fund authorized and created pursuant to the Trust Agreement.

"Debt Service Reserve Account" means the Debt Service Reserve Account authorized and created pursuant to the Trust Agreement.

"Depository" means any securities depository that is a clearing agency under federal law operating and maintaining, together with its participants a Book Entry System to record beneficial ownership of a series of Obligations, and to effect transfers of such Obligations, in Book Entry Form, and includes the Depository Trust Company (a limited purpose trust company), New York, New York.

"Direct Participant" means a Participant as defined in the Letter of Representations.

"Eligible Investments" means any investment authorized by Section 42.500 and 56.520(5) of the Kentucky Revised Statutes, as the same may be amended, modified, revised, supplemented, or superseded from time to time.

"Extraordinary Services" and "Extraordinary Expenses" means all services rendered and all reasonable expenses (including counsel fees) properly incurred by the Trustee under the Trust Agreement, other than Ordinary Services and Ordinary Expenses. Extraordinary Services and Extraordinary Expenses shall specifically include services rendered or expenses incurred by the Trustee in connection with, or in contemplation of, an Event of Default.

"Event of Default" means an Event of Default as defined in the Trust Agreement.

"Financial Statements" means the University's Annual Consolidated Financial Statements.

"Financing Agreement" means a "Financing Agreement" as defined in Chapter 56 of the Kentucky Revised Statutes between the University and ALCo or the applicable state agency as then provided by law. The definition of Financing Agreement does not include "Bond" or "Bonds," "Note" or "Notes" or Additional Obligation Instruments, but may also mean an SPBC Lease.

"Fiscal Officer" means either the Treasurer of the University or such other person designated by the Chairman of the Board to act as Fiscal Officer for purposes of the Trust Agreement.

"Fiscal Year" means a period of twelve consecutive months constituting the fiscal year of University commencing on the first day of July of any year and ending on the last day of June of the next succeeding calendar year, both inclusive, or such other consecutive twelve month period as hereafter may be established from time to time for budgeting and accounting purposes of the University by the Board to be evidenced, for purposes of the Financing Agreement, by a certificate of a Fiscal Officer filed with the Trustee.

"Fitch" means Fitch Ratings.

"General Receipts" means, as reported in the Financial Statements (having the designations, to the extent not otherwise defined in the Financing Agreement, set forth in the Financial Statements or such successor designations that may hereafter be used in Financial Statements):

(a) certain operating and non-operating revenues of the University, being (i) Student Registration Fees, (ii) nongovernmental grants and contracts, (iii) recoveries of facilities and administrative costs, (iv) sales and services, (v) Hospital Revenues, (vi) Housing and Dining Revenues, (vii) auxiliary enterprises – other auxiliaries, (viii) other operating revenues, (ix) state appropriations (for general operations), (x) gifts and grants, (xi) investment income, (xii) other nonoperating revenues and (xiii) other;

(b) but excluding (i) any receipts described in clause (a) which are contracts, grants, gifts, donations or pledges and receipts therefrom which, under restrictions imposed in such contracts, grants, gifts, donations or pledges, or, which as a condition of the receipt thereof or of amounts payable thereunder are not available for payment of Debt Service Charges, (ii) federal grants and contracts, (iii) state and local grants and contracts, (iv) federal appropriations, (v) county appropriations, (vi) professional clinical service fees, (vii) auxiliary enterprises – athletics; (viii) capital appropriations, (ix) capital grants and gifts, and (x) additions to permanent endowments, including research challenge trust funds;

provided, however, that General Receipts may

(c) include any other receipts that may be designated as General Receipts from time to time by a resolution of the Board delivered to the Trustee; and

(d) exclude any receipts not pledged under the Trust Agreement, which may be designated from time to time by a resolution of the Board delivered to the Trustee;

(e) exclude any receipts pledged under the Trust Agreement, which may be designated from time to time by a resolution of the Board delivered to the Trustee and each Rating Service then rating any Obligations, but only if each such Rating Service confirms in writing to the University that the exclusion of any such receipt would not cause a reduction or withdrawal of the then current rating on any Outstanding Obligations.

"Government Bonds" means (a) direct obligations of the United States of America for the payment of which the full faith and credit of the United States of America is pledged, (b) obligations issued by a Person controlled or supervised by and acting as an instrumentality of the United States of America, the payment of the principal of, premium, if any, and interest on which is fully guaranteed as a full faith and credit obligation of the United States of America (including any securities described in (a) or (b) issued or held in book-entry form on the books of the Department of Treasury of the United States of America or Federal Reserve Bank), and (c) securities which represent an interest in the obligations described in (a) and (b) above.

"Hedge Provider" means the provider of an Interest Rate Hedge Agreement.

"Holder" means any Person in whose name a registered Obligation is registered; provided that ALCo, or its assignee, shall be the Holder of any Financing Agreement and SPBC, or its assignee, shall be the Holder of any SPBC Lease.

"Hospital Revenues" means operating revenues having the designation "hospital services" in the Financial Statements or any successor designation or designations for such receipts that may hereafter be used in Financial Statements.

"Housing and Dining Bonds" means Obligations, the proceeds of which will be used to pay Costs of University Facilities which constitute Housing and Dining Facilities.

"Housing and Dining Facilities" means Housing and Dining Facilities, as defined in the Prior Housing Indenture.

"Housing and Dining Revenues" means operating revenues (auxiliary enterprises) having the designation "housing and dining" in the Financial Statements or any successor designation or designations for such receipts that may hereafter be used in Financial Statements.

"Indirect Participant" means a Person utilizing the Book Entry System of the Depository by, directly or indirectly, clearing through or maintaining a custodial relationship with a Direct Participant.

"Interest Payment Dates" means the dates specified in the applicable Series Resolution or Certificate of Award on which interest on the Obligations or any series of Obligations is to be paid.

"Interest Rate Hedge Agreement" means an interest rate swap, an interest rate cap or other such arrangement obtained, either directly by the University (or the Trustee on behalf of the University) or through ALCo, with the goal of lowering the effective interest rate to the University on Obligations or hedging the exposure of the University with respect to its obligations on the Obligations against fluctuations in prevailing interest rates.

"Letter of Representations" means the Blanket Letter of Representations from the University to the Depository.

"Mandatory Sinking Fund Requirements" means amounts required by any Series Resolution or the Certificate of Award to be deposited to the Debt Service Payment Account in any fiscal year for the purpose of retiring principal maturities of Obligations which by the terms of such Obligations are due and payable, if not called for prior redemption, in any subsequent fiscal year.

"Maximum Annual Debt Service" means the highest amount of (i) Debt Service Charges plus (ii) the principal of and interest on all Prior Obligations that are outstanding under the terms of the Prior Basic Resolution or the Prior Housing Indenture, for the current or any future Fiscal Year.

"Moody's" means Moody's Investors Service, Inc., a Delaware corporation, and its successors and assigns.

"Notes" or "Note" means any note or all of the notes, or an issue of notes, as the case may be, as so identified in the certificate of the Fiscal Officer issued by the University in anticipation of the issuance of Obligations or receipt of grants or appropriations to pay Costs of University Facilities, or to pay costs of refunding or retirement of Notes previously issued pursuant to the Act, the 2005 General Bond Resolution, a Series Resolution and the Trust Agreement. The definition of Note and Notes does not include "Bond" or "Bonds," Financing Agreements, SPBC Leases or Additional Obligation Instruments.

"Obligations" means Bonds, Notes, Financing Agreements, SPBC Leases and Additional Obligation Instruments.

"Ordinary Services" and "Ordinary Expenses" means those services normally rendered and those expenses (including counsel fees) normally incurred by a trustee under instruments similar to the Trust Agreement.

"Original Purchaser" means, as to any Obligations, the Person or Persons expressly named in the applicable Series Resolution or the Certificate of Award as the original purchaser of those Obligations from the University.

"Outstanding" means, as of any date, Notes and Bonds which have been authenticated, and with respect to all Obligations, have been delivered, or are then being delivered, by the Trustee or the University under the Trust Agreement except:

(a) Obligations surrendered for exchange or transfer or canceled because of payment or redemption at or prior to such date;

(b) Obligations for the payment, redemption or purchase for cancellation of which sufficient moneys have been deposited prior to such date with the Trustee or Paying Agents (whether upon or prior to the maturity or redemption date of any such Obligations), or which are deemed to have been paid and discharged pursuant to the provisions of the Trust Agreement; provided that if such Obligations are to be redeemed prior to the maturity thereof, notice of such redemption shall have been given or arrangements satisfactory to the Trustee shall have been made there for, or waiver of such notice satisfactory in form to the Trustee shall have been filed with the Trustee, and provided, further, that if such Obligations are to be purchased for cancellation, a firm offer for sale stating the price has been received and accepted; and

(c) Lost, stolen, mutilated or destroyed Obligations in lieu of which others have been authenticated, if applicable, (or payment, when due, of which is made without replacement) under the Trust Agreement.

"Paying Agents" means any banks or trust companies designated as the paying agencies or places of payment for Obligations by or pursuant to the applicable Series Resolution, and their successors designated pursuant to the Trust Agreement, and shall also mean the Trustee when so designated for such purpose.

"Person" means an individual, a corporation, a partnership, an association, a joint stock company, a joint venture, a trust, an unincorporated organization, or a government or any agency or political subdivision thereof.

"Predecessor Obligation" of any particular Obligation means every previous Obligation evidencing all or a portion of the same debt as that evidenced by the particular Obligation. For the purposes of this definition, any Bond or Note authenticated and delivered under the Trust Agreement in lieu of a lost, stolen or destroyed Bond or Note shall, except as otherwise provided in the Trust Agreement, be deemed to evidence the same debt as the lost, stolen or destroyed Bond or Note.

"Prior Basic Resolution" means the resolution adopted by the Board on September 20, 1960, that has provided for the issuance of Consolidated Educational Buildings Revenue Bonds of the University.

"Prior Financing Documents" means, collectively, the Prior Basic Resolution and the Prior Housing Indenture.

"Prior Funds" means all funds and accounts created by the Prior Financing Documents that are pledged as security and a source of payment of bonds and notes issued thereunder.

"Prior Housing Indenture" the Trust Indenture and Supplemental Trust Indenture dated as of June 1, 1965 (and all supplemental indentures related thereto) between the University and Farmers' Bank & Capital Trust Company that, has provided for the issuance of Housing and Dining Bonds.

"Prior Obligations" means any notes or bonds that are outstanding under the Prior Financing Documents.

"Prior Pledged Funds" means, collectively, all funds and accounts created under the Prior Financing Documents.

"Prior Pledged Revenues" means amounts required to be deposited in the "Revenue Fund" created by the Prior Basic Resolution and in the "System Revenue Fund" created by the Prior Housing Indenture.

"Project Fund" means the Project Fund created pursuant to the Trust Agreement.

"Purchase Price" means, as to any series of Obligations, the amount provided for in the Series Resolution and the Certificate of Award authorized thereby, plus accrued interest, if any, on the aggregate principal amount of those Obligations from their date to the date of their delivery to the Original Purchaser and payment therefor.

"Rating Service" means Fitch, Moody's, S&P or any other nationally recognized rating service.

"Redemption and Purchase Account" means the Redemption and Purchase Account authorized and created pursuant to the Trust Agreement.

"Register" means the books kept and maintained by the Registrar for the registration and transfer of Obligations pursuant to the Trust Agreement.

"Registrar" means, with respect to a series of Obligations, the keeper of the Register for those Obligations, which shall be the Trustee except as may be otherwise provided by or pursuant to the Series Resolution for those Obligations, each of which shall be a transfer agent registered in accordance with Section 17(A)(c) of the Securities Exchange Act of 1934.

"Regular Record Date" means, with respect to any Obligation and unless otherwise provided in the Series Resolution authorizing the particular series of Obligations, the fifteenth day of the calendar month next preceding an Interest Payment Date applicable to that Obligation.

"Reimbursement Agreement" means, with respect to a series of Obligations, any agreement or agreements between one or more Credit Support Providers and the University under or pursuant to which a Credit Support Instrument for such series of Obligations is issued or provided and which sets forth the respective obligations of the University and of the Credit Support Provider.

"Remarketing Agent" means any entity which acts as the remarketing agent with respect to a series of Obligations.

"Revenue Fund" means the Revenue Fund authorized and created pursuant to the Trust Agreement.

"S&P" means Standard & Poor's Rating Services, a Division of The McGraw Hill Companies, and its successors and assigns.

"Series Resolution" means a Resolution of the Board authorizing one or more series of Obligations and the execution and delivery of a Supplemental Trust Agreement, all in accordance with the 2005 General Bond Resolution and the Trust Agreement.

"SPBC" means the State Property and Buildings Commission of the Commonwealth and any successor thereto.

"SPBC Lease" means a lease between the University and SPBC or the applicable state agency as then provided by law. The definition of SPBC Lease does not include "Bond" or "Bonds," "Note" or "Notes" or Additional Obligation Instruments, but may also mean a Financing Agreement.

"Special Funds" means the Debt Service Fund and accounts therein and any other funds or accounts permitted by, established under, or identified in the Trust Agreement or a Series Resolution and designated as Special Funds. The Revenue Fund shall not be a Special Fund.

"Student Registration Fees" means operating revenues having the designation "student tuition and fees" in the Financial Statements or any successor designation or designations for such receipts that may hereafter be used in Financial Statements.

"Subordinated Indebtedness" means obligations which, with respect to any issue thereof, are secured by a pledge of the General Receipts which is subordinate to that of the holders of Obligations and which are evidenced by instruments, or issued under an indenture or other document, containing provisions for the subordination of such obligations.

"Supplemental Trust Agreement" means any one or more of Supplemental Trust Agreements entered into by the parties pursuant to the Trust Agreement and a Series Resolution.

"Tender Agent" means any entity which acts as a tender agent for a series of Obligations.

"Trust Agreement" means the Trust Agreement, dated as of November 1, 2005, between the University and the Trustee, as the same may be duly amended, modified or supplemented in accordance with its terms.

"Trustee" means the Trustee at the time serving under the Trust Agreement, originally U.S. Bank National Association and any successor Trustee as determined or designated under or pursuant to the Trust Agreement.

"2005 General Bond Resolution" means the resolution of the Board adopted on September 20, 2005, authorizing the execution and delivery of the Trust Agreement.

"University" means the University of Kentucky, a public body corporate, and an educational institution and agency of the Commonwealth of Kentucky, and every part and component thereof as from time to time existing, and when the context requires, includes the Board.

"University Facilities" means buildings and appurtenances to be used in connection with the University for educational purposes, including, but not limited to any Authorized Project, any Building, any Building project and any Public project, as those terms are defined in the Act, and further includes any one, part of, or any combination of such facilities, and further includes site improvements, utilities, machinery, furnishings and any separate or connected buildings, structures, improvements, sites, open space and green space areas, utilities or equipment to be used in, or in connection with the operation or maintenance of, or supplementing or otherwise related to the services or facilities to be provided by such facilities.

Any reference in the Financing Agreement to the University, the Board, or to any officers or to other public boards, commissions, departments, institutions, agencies, bodies, entities or officers, shall include those which succeed to their functions, duties or responsibilities pursuant to or by operation of law or who are lawfully performing their functions. Any reference to a section or provision of the Kentucky Revised Statutes or to the laws of Kentucky shall include such section or provision and such laws as from time to time amended, modified, revised, supplemented, or superseded, provided that no such amendment, modification, revision, supplementation, or super session shall alter the obligation to pay the Debt Service Charges in the amount and manner, at the times, and from the sources provided in this Resolution, the applicable Series Resolution, and the Trust Agreement, except as otherwise permitted in the Trust Agreement.

**Debt Service Fund and Other Special Funds**

The Trustee will hold and administer the Debt Service Fund and any other Special Fund created under the Trust Agreement, together with the accounts contained therein, upon the terms and conditions, including, without limitation, the terms and conditions set forth in the Trust Agreement and the applicable

Series Resolution and/or Supplemental Trust Agreement for the investment of moneys deposited in such Funds, set forth in the applicable Series Resolution and the Trust Agreement.

There will be maintained in the Debt Service Fund the following Accounts: the Debt Service Payment Account, the Debt Service Reserve Account and the Redemption and Purchase Account. The Trustee will maintain a separate subaccount within the Debt Service Payment Account for each series of Obligations and each separate subaccount will secure only the particular series of Obligations to which it is related. (Section 4.1)

**Use of Debt Service Payment Account; Intercept**

The Debt Service Account is pledged to and will be used solely for the payment of Debt Service Charges as they fall due. Payments sufficient in an amount to pay the Debt Service Charges as they become due will be paid by the University directly to the Trustee, and deposited in the Debt Service Payment Account to the extent moneys in the Debt Service Payment Account are not otherwise available therefore. Upon the occurrence and during the continuation of an Event of Default described in the Trust Agreement with respect to a specific series of Obligations, if a subaccount in the Debt Service Reserve Account has been created to secure such series of Obligations, moneys in the applicable subaccount of the Debt Service Reserve Account may be transferred by the Trustee to the Debt Service Payment Account to be used to pay Debt Service Charges with respect to such series of Obligations pursuant to the Trust Agreement. Except as provided in the Trust Agreement, moneys in the Debt Service Payment Account shall be used solely for the payment of Debt Service Charges on the Obligations, for the redemption of Obligations prior to maturity, for the payment of any amounts due to a Credit Support Provider to the extent as set forth in a Credit Support Instrument, for the payment of any amounts due to a Hedge Provider to the extent as set forth in an Interest Rate Hedge Agreement and as otherwise provided in the Trust Agreement and the 2005 General Bond Resolution.

If, ten days prior to any date that the payment of Debt Service Charges are due, sufficient funds are not on deposit in the Debt Service Payment Account to enable the Trustee to pay such Debt Service Charges, or if the Trustee shall have transferred funds form a Debt Service Reserve Account to the Debt Service Payment Account to forestall a default in the payment of Debt Service Charges, then in each such instance the Trustee shall immediately notify the Treasurer of the University and the Secretary of the Finance and Administration Cabinet of the Commonwealth in writing of such event and request that amounts be remitted to the Trustee pursuant to the then applicable provisions of Section 164A.608 of the Kentucky Revised Statutes to cure such deficiency or to restore the amount transferred from the Debt Service Reserve Account. (Section 4.2)

**Debt Service Reserve Account**

The Trustee will hold and administer a Debt Service Reserve Account to be used, solely for the payment of Debt Service Charges with respect to any series of Obligations for which a reserve fund has been mandated pursuant to the Series Resolution which authorized the issuance of such series of Obligations. A separate subaccount shall be created in the Supplemental Debt Service Reserve Account for each series of Obligations for which a reserve fund has been mandated by the Series Resolution which authorized such series of Obligations and each separate subaccount shall secure only the particular series of Obligations to which it is related.

If, on the date upon which Debt Service Charges on any Obligations which are secured by a Debt Service Reserve Account or subaccount held by the Trustee fall due, the subaccount within the Debt Service Payment Account related to such Obligations is insufficient to meet such Debt Service Charges to be paid therefrom on such date, the Trustee will immediately transfer from the appropriate subaccount of the Debt Service Reserve Account an amount sufficient to make up such deficiency in the subaccount of the Debt Service Payment Account. Except as may be provided in the applicable Series Resolution or Supplemental Trust Agreement, if on the day upon which amounts are due to a Hedge Provider under an

Interest Rate Hedge Agreement or are due to a Credit Support Provider in reimbursement for amounts provided under a Credit Support Instrument, the amount in the subaccount within the Debt Service Payment Account related to such Debt Service Charges (other than from any amounts provided under an Interest Rate Hedge Agreement or Credit Support Instrument) is insufficient to pay such amounts to such Hedge Provider or Credit Support Provider on that date, the Trustee, without necessity for any further order of the University or officer thereof, will make available for such reimbursement any amounts in the related subaccount of the Debt Service Reserve Account for the series of Obligations to which the Interest Rate Hedge Agreement or Credit Support Instrument applies that are necessary to make up that insufficiency. The amount so transferred will be applied only to the payment of Debt Service Charges on the Obligations to which that Debt Service Reserve Account pertains or for the payment of any amounts due to a Hedge Provider under an Interest Rate Hedge Agreement or to a Credit Support Provider as reimbursement of draws under a Credit Support Instrument in connection with the Obligations to which that Debt Service Reserve Account pertains.

Subject to the foregoing, any amount in a subaccount of the Debt Service Reserve Account in excess of the amount required to be maintained therein pursuant to the Series Resolution which created such subaccount or the Certificate of Award (the "Required Amount") will be transferred to the Debt Service Payment Account or to the Redemption and Purchase Account for the purposes thereof, if and to the extent ordered by the Fiscal Officer. Such excess will be determined by calculating the Required Amount with reference to Outstanding Obligations of the particular series only, excluding any Obligations for the redemption or purchase of which such excess is being transferred to the Redemption and Purchase Account.

Within one hundred eighty (180) days after the end of each Fiscal Year, the University shall, from General Receipts, restore to the various subaccounts within the Debt Service Reserve Account any amounts transferred therefrom or any decrease in value determined pursuant to Section 4.14 of the Trust Agreement in such Fiscal Year so that the amounts in such subaccounts are at least equal to the various Required Amounts. (Section 4.03)

**Redemption and Purchase Account**

There will be deposited in the Redemption and Purchase Account that portion (if any) of the proceeds of refunding Obligations, as provided in the Series Resolution authorizing their issuance, allocated to the payment of the principal, interest and redemption premium, if any, or purchase price of the Obligations to be refunded, funded or retired through the issuance of such refunding Obligations; amounts to be transferred thereto from the Debt Service Reserve Account by order of the Fiscal Officer pursuant to Section 4.03 of the Trust Agreement; and any other amounts made available by the University for the purposes of the Redemption and Purchase Account. Amounts for the redemption of Obligations to be provided pursuant to the mandatory sinking fund requirements of the Series Resolution authorizing such Obligations will not be deposited to the credit of the Redemption and Purchase Account, but shall be deposited to the credit of the Debt Service Payment Account.

Any amounts in the Redemption and Purchase Account may be committed, by Series Resolution or other action by the Board, for the retirement of and for Debt Service Charges on specified Obligations and, so long as so committed, will be used solely for such purposes whether directly or through transfer to the Debt Service Fund. Subject to the foregoing provisions of the Trust Agreement, the Fiscal Officer may cause moneys in the Redemption and Purchase Account to be used to purchase any Obligations for cancellation and to redeem any Obligations in accordance with the redemption provisions of the applicable Series Resolution. From moneys in the Redemption and Purchase Account, the Trustee will transmit or otherwise disburse such amounts at such times as required for the redemption or purchase for cancellation of Obligations, and Debt Service Charges, in accordance with the applicable Series Resolution, or other action by the Board or order of the Fiscal Officer not inconsistent therewith. Any amounts in the Redemption and Purchase Account not required for the purposes thereof pursuant to a commitment theretofore made, may be transferred to the Debt Service Payment Account or the Debt Service Reserve Account upon order of the Fiscal Officer. (Section 4.04)

**Project Fund**

Upon the issuance and delivery of Obligations, the proceeds of which will be used to pay Costs of University Facilities, the Treasury of the Commonwealth, will hold and administer a fund designated the "University of Kentucky Project Fund" with an additional series identification for each series of Obligations.

Amounts in a Project Fund will be disbursed therefrom by the Treasurer of the Commonwealth according to such inspection, audit, and disbursement procedures as may from time to time be provided by law, for the purpose of paying Costs of University Facilities as identified in the related Series Resolution or Supplemental Trust Agreement and to reimburse the University for any payments which may have been made from other available resources in anticipation of the issuance of such Obligations.

Any balance remaining in a Project Fund after the final payment of all Costs of University Facilities for which such Project Fund was created, will be deposited in the Debt Service Fund and (i) credited to the related subaccount, if any, within the Debt Service Reserve Account if and to the extent that such subaccount of the Debt Service Reserve Account contains less than the Required Amount, and/or (ii) either applied as a credit against the next deposit required to be made into the Debt Service Payment Fund, or used to purchase Obligations in the open market at a purchase price not exceeding par plus accrued interest, as may be directed by the Fiscal Officer; provided that, if proceedings are then pending or imminently contemplated for incurring additional Costs of University Facilities which are or will be paid from the proceeds of Obligations, any such unexpended balance may be taken into account in determining the amount of Obligations to be authorized for such purpose, or may otherwise be applied to such Costs of University Facilities, in which event such unexpended balance may be transferred to a Project Fund created for such purpose.

If so provided in any Series Resolution or a Supplemental Trust Agreement, to the extent permitted by law, a Project Fund may be held and disbursed by the Trustee. Furthermore, if the Obligations with respect to which a Project Fund is created are Financing Agreements, SPBC Leases or Additional Obligation Instruments, a Project Fund may be created in accordance with the requirements of such Financing Agreements, SPBC Leases or Additional Obligation Instruments. (Section 4.05)

**General Covenant**

So long as any Obligations are Outstanding pursuant to the Trust Agreement, the University covenants and agrees: (i) to fix, make, adjust and collect such fees, rates, rentals, charges and other items of General Receipts so that there shall inure to the University General Receipts, in view of other revenues and resources available to the University, sufficient: to pay Debt Service Charges then due or to become due in the current Fiscal Year; to pay any other costs and expenses payable under the Trust Agreement; and to pay all other costs and expenses necessary for the proper maintenance and successful and continuous operation of the University; and (ii) that it will include in its budget for each Fiscal Year the amount required to be paid to the Debt Service Fund established under Section 4.02 of the Trust Agreement, during such Fiscal Year. (Section 4.12)

**Investment of Debt Service Fund and Project Fund**

Except as provided in the Trust Agreement, moneys in the Debt Service Fund and the Project Fund shall be invested and reinvested by the Trustee (or the Fiscal Officer, as applicable) in Eligible Investments at the oral or written direction of the University, but if oral, confirmed promptly in writing. Investment of moneys in the Debt Service Fund shall mature or be redeemable at the times and in the amounts necessary to provide moneys to pay Debt Service Charges as they become due at stated maturity, by redemption or pursuant to any mandatory sinking fund requirements. Each investment of moneys in the Debt Service Fund and the Project Fund will mature or be redeemable without penalty at such time as may be necessary to make payments when necessary from such fund. In the absence of any written direction from the Fiscal Officer, the Trustee will invest all funds in sweep accounts, money-market funds and similar short-term investments, provided that all such investments shall constitute Eligible Investments. The Trustee may trade with itself or its affiliates in the purchase and sale of securities for such investments.

Subject to any directions from the University with respect thereto, the Trustee may sell at the best price reasonably obtainable Project Fund investments and reinvest the proceeds therefrom in Eligible Investments maturing or redeemable as aforesaid. Any of those investments may be purchased from or sold to the Trustee, the Registrar, an Authenticating Agent, a Paying Agent, or any bank, trust company or savings and loan association affiliated with any of the foregoing. The Trustee will sell or redeem investments credited to the Debt Service Fund to produce sufficient moneys applicable under the Trust Agreement to and at the times required for the purposes of paying Debt Service Charges when due as aforesaid, and shall do so without necessity for any order on behalf of the University and without restriction by reason of any order. An investment made from moneys credited to the Debt Service Fund and the Project Fund will constitute part of that respective fund, and each respective fund will be credited with all proceeds of sale and income from investment of moneys credited thereto.

For purposes of qualifying any investment as an Eligible Investment, where such qualification is dependent upon the rating assigned to such investment by a Rating Service, such qualification will be determined as of the date of purchase of such investment or deposit thereof with the Trustee, whichever is later. (Section 4.15)

**Revenue Fund**

So long as any Obligations remain Outstanding, there will be maintained a Revenue Fund, which, to the extent required by law, may be a fund (and accounts) in the Commonwealth's management administrative and reporting system. There will be maintained in the Revenue Fund the following Accounts: a "Student Registration Fees Account," a "Hospital Revenues Account" and a "Housing and Dining Revenues Account." The "Revenue Fund" created pursuant to the Prior Bond Resolution will continue to be maintained so long as any bonds remain outstanding under the Prior Bond Resolution, such Revenue Fund will constitute the Student Registration Fees Account of the Revenue Fund until there are no bonds outstanding under the Prior Bond Resolution and all Student Registration Fees will be deposited therein. The "Revenue Fund" created pursuant to a Master Resolution adopted by the Board on June 25, 1986 will continue to be maintained as the Hospital Revenues Account of the Revenue Fund and all Hospital Revenues shall be deposited therein. The "System Revenue Fund" created pursuant to the Prior Housing Indenture will continue to be maintained so long as any bonds remain outstanding under the Prior Housing Indenture, such System Revenue Fund will constitute the Housing and Dining Revenues Account of the Revenue Fund until there are no bonds outstanding under the Prior Housing Indenture and all Housing and Dining Revenues will be deposited therein. (Section 4.16)

**Maintenance of Pledge**

The University will not make any pledge or assignment of or create or suffer any lien or encumbrance upon the Debt Service Fund and, except for the existing pledges under the Prior Basic Resolution and Prior Housing Indenture, the University will not make any pledge or assignment of or create or suffer any lien or encumbrance upon the General Receipts prior to or on a parity with the pledge thereof under the Trust Agreement, except as authorized or permitted under the Trust Agreement. The University will issue no additional bonds or notes under the Prior Basic Resolution. The University will issue no additional bonds or notes under the Prior Housing Indenture unless, with respect to a series of Housing and Dining Bonds, (i) such bonds or notes could be issued as Obligations under the Trust Agreement within the limitations set forth in Section 2.01 of the Trust Agreement and (ii) it is provided in the supplemental indenture authorizing such notes or bonds that on the date no Housing and Dining Bonds are outstanding under the Prior Housing Indenture, other than notes or bonds issued in accordance with Section 4.18 of the Trust Agreement, the lien securing such Housing and Dining Bonds created by the Prior Housing Indenture will terminate and such Housing and Dining Bonds will continue as Obligations under the Trust Agreement on a parity with all other Obligations. (Section 4.18)

**Events of Default**

Events of Default under the Trust Agreement include:

(a) Failure to pay any Debt Service Charges when and as the same becomes due and payable;

(b) Failure to pay the principal of or any premium on any Prior Obligations when and as the same becomes due and payable, whether at the stated maturity thereof or by redemption or acceleration or pursuant to any mandatory sinking fund requirements;

(c) Failure by the University to perform or observe any other covenant, agreement or condition on the part of the University contained in the Trust Agreement or in the Obligations, which failure or Event of Default shall have continued for a period of 30 days after written notice, by registered or certified mail, given to the University by the Trustee, specifying the failure or Event of Default and requiring the same to be remedied, which notice shall be given by the Trustee upon the written request of the Holders of not less than twenty-five percent in aggregate principal amount of the Obligations then Outstanding; provided that the Person or Persons requesting such notice may agree in writing to a 90-day extension of such period prior to the expiration of the initial 30-day period; provided further, however, that if the University will proceed to take curative action which, if begun and prosecuted with due diligence, cannot be completed within a period of 90 days, then such period shall be increased without such written extension up to 180 days as will be necessary to enable the University to diligently complete such curative action;

(d) The University will (i) admit in writing its inability to pay its debts generally as they become due, (ii) have an order for relief entered in any case commenced by or against it under federal bankruptcy laws, as now or hereafter in effect, (iii) commence a proceeding under any federal or state bankruptcy, insolvency, reorganization or similar laws, or have such a proceeding commenced against it and have either an order of insolvency or reorganization entered against it or have the proceeding remain undismissed and unstayed for 90 days, (iv) make an assignment for the benefit of creditors, or, (v) have a receiver or trustee appointed for it or for the whole or substantial part of its property. (Section 6.01)

**Supplemental Trust Agreements Not Requiring Consent of Holders**

The University and the Trustee without the consent of, or notice to, any of the Holders, may enter into indentures supplemental to the Trust Agreement and other instruments evidencing the existence of a lien as shall not, in the opinion of the Trustee, be inconsistent with the terms and provisions of the Trust Agreement for any one or more of the following purposes:

(a) To cure any ambiguity, inconsistency or formal defect or omission in the Trust Agreement or in any Supplemental Trust Agreement;

(b) To grant to or confer upon the Trustee for the benefit of the Holders any additional rights, remedies, powers or authority that may lawfully be granted to or conferred upon the Holders or the Trustee;

(c) To subject additional revenues or property to the lien and pledge of the Trust Agreement;

(d) To add to the covenants and agreements of the University contained in the Trust Agreement other covenants and agreements thereafter to be observed for the protection of the Holders, or, if in the judgment of the Trustee such is not to the prejudice of the Trustee or the Holders, to surrender or limit any right, power or authority reserved to or conferred upon the University in the Trust Agreement, including the limitation of rights of redemption so that in certain instances Obligations of different series will be redeemed in some prescribed relationship to one another;

(e) To evidence any succession to the University and the assumption by such successor of the covenants and agreements of the University contained in the Trust Agreement or other instrument providing for the operation of the University or University Facilities, and the Obligations;

(f) In connection with the issuance of Obligations in accordance with Sections 2.01 and 2.02 of the Trust Agreement;

(g) To permit the Trustee to comply with any obligations imposed upon it by law;

(h) To permit the exchange of Obligations, at the option of the Holder or Holders thereof, for coupon Obligations of the same series payable to bearer, in an aggregate principal amount not exceeding the unmatured and unredeemed principal amount of the Predecessor Obligations, bearing interest at the same rate or rates and maturing on the same date or dates, with coupons attached representing all unpaid interest due or to become due thereon if, in the opinion of nationally recognized Bond Counsel selected by the University and acceptable to the Trustee, that exchange would not result in the interest on any of the Obligations Outstanding becoming subject to federal income taxation;

(i) To specify further the duties and responsibilities of, and to define further the relationship among, the Trustee, the Registrar and any Authenticating Agents or Paying Agents;

(j) To achieve compliance of the Trust Agreement with any applicable federal or Kentucky laws, including tax laws;

(k) To modify any provisions of the Trust Agreement in order to obtain a Credit Support Instrument or Interest Rate Hedge Agreement, so long as such modifications affect only the Obligations to which such Credit Support Instrument or Interest Rate Hedge Agreement relate; and

(l) In connection with any other change to the Trust Agreement which, in the judgment of the Trustee, is not to the material prejudice of the Trustee or the Holders of the Obligations.

The provisions of (g) and (j) above will not be deemed to constitute a waiver by the Trustee, the Registrar, the University or any Holder of any right which it may have in the absence of those provisions to consent to the application of any change in law to the Trust Agreement or the Obligations. (Section 7.01)

**Supplemental Trust Agreements Requiring Consent of Holders**

Exclusive of supplemental indentures referred to in Section 7.01 of the Trust Agreement and subject to the terms and provisions and limitations contained in this paragraph, and not otherwise, the

Holders of a majority in aggregate principal amount of the Obligations then Outstanding shall have the right, from time to time, anything contained in the Trust Agreement to the contrary notwithstanding, to consent to and approve the execution by the University and the Trustee of such other indenture or indentures supplemental to the Trust Agreement as shall be deemed necessary and desirable by the University for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Trust Agreement; provided that nothing in this paragraph or in the Trust Agreement will permit, or be construed as permitting, a Supplemental Trust Agreement providing for (a)(i) a reduction in the percentage of Obligations the consent of the Holders of which are required to consent to such Supplemental Trust Agreement or (ii) a preference or priority of any Obligation or Obligations over any other Obligation or Obligations, without the consent of the Holders of all Obligations then Outstanding, (b) effect a change in the times, amount or currency of payment of the principal of, premium, if any, on or interest on any Obligation or a reduction in the principal amount or redemption price of any Obligation or the rate of interest thereon, without the consent of the Holder of each such Obligation so affected or (c) modify the right of the Holders of not less than twenty-five percent in aggregate principal amount of the Obligations then Outstanding and in default as to payment of principal, premium or interest to compel the Trustee to declare the principal of all Obligations to be due and payable, without the consent of the Holders of a majority in aggregate principal amount of the Obligations then Outstanding.

If at any time the University request the Trustee to enter into any such Supplemental Trust Agreement for any of the purposes of Section 7.02 of the Trust Agreement, the Trustee, upon being satisfactorily indemnified with respect to expenses, shall cause notice of the proposed execution of such Supplemental Trust Agreement to be mailed by first class mail, postage prepaid, to all Holders of Obligations then Outstanding at their addresses as they appear on the Registrar at the close of business on the Business Day immediately preceding that mailing. The Trustee will not, however, be subject to any liability to any Holder by reason of its failure to mail, or the failure of such Holder to receive, the notice required by the Trust Agreement, and any such failure shall not affect the validity of such Supplemental Trust Agreement when consented to and approved as provided in Section 7.02 of Trust Agreement. Such notice will briefly set forth the nature of the proposed Supplemental Trust Agreement and will state that copies thereof are on file at the principal corporate trust office of the Trustee for inspection by all Holders.

If within such period, not exceeding one year, as prescribed by the University, following the mailing of such notice, the Trustee receives an instrument or instruments purporting to be executed by the Holders of a majority in aggregate principal amount of the Obligations then Outstanding, which instrument or instruments shall refer to the proposed Supplemental Trust Agreement described in such notice and will specifically consent to and approve the execution thereof in substantially the form of the copy thereof referred to in such notice as on file with the Trustee, thereupon, but not otherwise, the Trustee will execute such Supplemental Trust Agreement in substantially such form; without liability or responsibility to any Holder of any Obligation, whether or not such Holder will have consented thereto.

Any such consent is binding upon the Holder of the Obligation giving such consent, upon any subsequent Holder of such Obligation and upon the Holder of any Obligation issued in exchange therefor (whether or not such subsequent Holder thereof has notice thereof), unless such consent is revoked in writing by the Holder of such Obligation giving such consent or by a subsequent Holder thereof by filing with the Trustee, prior to the execution by the Trustee of such Supplemental Trust Agreement, such revocation and, if such Obligation or Obligations are transferable by delivery, proof that such Obligations are held by the signer of such revocation in the manner permitted by Section 9.01 of the Trust Agreement. At any time after the Holders of the required percentage of the Obligations shall have filed their consents to the Supplemental Trust Agreement, the Trustee shall make and file with the University a written statement that the, Holders of such required percentage of the Obligations have filed such consents. Such written statement shall be conclusive evidence that such consents have been so filed.

If the Holders of the required percentage in aggregate principal amount of the Obligations shall have consented to and approved the execution thereof as provided in the Trust Agreement, no Holder of any Obligation has any right to object to the execution of such Supplemental Trust Agreement, to object to any of the terms and provisions contained therein or the operation thereof, or in any manner to question the propriety of the execution thereof or to enjoin or restrain the Trustee or the University from executing the same or from taking any action pursuant to the provisions thereof.

**Authorization to the Trustee; Effect of Supplemental Trust Agreements**

The Trustee is authorized to join with the University in the execution of any such Supplemental Trust Agreement provided for in the Trust Agreement and to make the further agreements and stipulations which may be contained therein. Any Supplemental Trust Agreement executed in accordance with the provisions of the Trust Agreement will thereafter form a part of the Trust Agreement, all the terms and conditions contained in any such Supplemental Trust Agreement as to any provision authorized to be contained therein will be deemed to be part of the terms and conditions of the Trust Agreement for any and all purposes, the Trust Agreement will be and be deemed to be modified and amended in accordance therewith, and the respective rights, duties and obligations under the Trust Agreement of the University, the Trustee, the Registrar, the Authenticating Agents, the Paying Agents and all Holders of Obligations then Outstanding will thereafter be determined, exercised and enforced thereunder, subject in all respects to such modifications and amendments. Express reference to such executed Supplemental Trust Agreement may be made in the text of any Obligations issued thereafter, if deemed necessary or desirable by the Trustee or the University. There will be no modification, change or amendment to the Trust Agreement or any other document related to the Obligations which affects the rights, duties or obligations of the Trustee thereunder, without the Trustee's prior written consent.

**Opinion of Counsel**

The Trustee is entitled to receive, and shall be fully protected in relying upon, the opinion of any counsel approved by it, who may be counsel for the University, as conclusive evidence that any such proposed Supplemental Trust Agreement complies with the provisions of the Trust Agreement and that it is proper for the Trustee, under the provisions of the Trust Agreement, to join in the execution of such Supplemental Trust Agreement. (Section 7.04)

**Modification by Unanimous Consent**

Notwithstanding anything contained elsewhere in the Trust Agreement, the rights and obligations of the University and of the Holders of the Obligations, and the terms and provisions of the Obligations and the Trust Agreement or any Supplemental Trust Agreement, may be modified or altered in any respect with the consent of the University and the consent of the Holders of all of the Obligations then Outstanding and the Trustee. (Section 7.05)

**Release of Trust Agreement**

If the University pays or cause to be paid and discharged, or there shall otherwise by paid to the Holders of the Outstanding Obligations all Debt Service Charges due or to become due thereon and provision shall also be made for paying all other sums payable under the Trust Agreement, then and in that event the Trust Agreement (except for Sections 4.02, 4.04, 4.05, 8.02 and 8.03 thereof) will cease, determine and become null and void, and the covenants, agreements, and other obligations of the University under the Trust Agreement are discharged and satisfied, and thereupon the Trustee will release the Trust Agreement, including the cancellation and discharge of the lien thereof, and execute and deliver to the University such instruments in writing as required to satisfy and terminate the lien thereof and to enter on the records such satisfaction and discharge and to re-convey to the University the estate created by the Trust Agreement and such other instruments to evidence such release and discharge as may be reasonably required by the University, and the Trustee and Paying Agents will assign and deliver to the

University any property at the time subject to the lien of the Trust Agreement which may then be in their possession, except amounts in the Debt Service Fund required to be held by the Trustee and Paying Agents under Section 4.07 of the Trust Agreement or otherwise for the payment of Debt Service Charges. (Section 8.01)

**Payment and Discharge of Obligations**

All the Outstanding Obligations of one or more series will be deemed to have been paid and discharged within the meaning of the Trust Agreement, including without limitation, Section 8.01 of the Trust Agreement if either (i) the Trustee as paying agent and any Paying Agents are required to hold, in the Debt Service Payment Account in trust for and irrevocably committed thereto, sufficient moneys or (ii) the Trustee is required to hold, in the Debt Service Fund in trust for and irrevocably committed thereto, investments qualifying as Government Bonds as of the date of the determination required in Section 8.02 of the Trust Agreement which are, in either case, certified by an independent public accounting firm of national reputation to be of such maturities and interest payment dates and to bear such interest as will, without further investment or reinvestment of either the principal amount thereof or the interest earnings therefrom (likewise to be held in trust and committed, except as provided in the Trust Agreement), be sufficient together with moneys referred to in clause (i) above, for the payment, at their maturity, redemption or due date, as the case may be, of all Debt Service Charges on those Obligations to their maturity, redemption or due date, as the case may be, or if Event of Default in such payment will have occurred on such date then to the date of the tender of such payment; provided that if any of such Obligations are to be redeemed prior to the maturity thereof, notice of such redemption will have been duly given or irrevocable provisions satisfactory to the Trustee have been duly made for the giving of such notice; provided that if the Obligations are to be redeemed prior to the maturity thereof, notice of such redemption shall have been duly given or irrevocable provision satisfactory to the Trustee shall have been duly made for the giving of such notice. (Section 8.01)

**Survival of Certain Provisions**

Notwithstanding the foregoing, those provisions of a Series Resolution and the Trust Agreement relating to the maturity of Obligations, interest payments and dates thereof, optional and mandatory redemption provisions, credit against Mandatory Sinking Fund Requirements, exchange, transfer and registration of Obligations, replacement of mutilated, destroyed, lost or stolen Obligations, the safekeeping and cancellation of Obligations, non-presentment of Obligations, the holding of moneys in trust, repayments to the University from the Special Funds and the rights, remedies and duties of the Trustee and the Registrar in connection with all of the foregoing, shall remain in effect and shall be binding upon the Trustee, the Registrar, the Authenticating Agent, Paying Agents and the Holders notwithstanding the release and discharge of the lien of the Trust Agreement. The provisions of the Article XIII of the Trust Agreement shall survive the release and discharge of the Trust Agreement. (Section 8.03)

**Limitation of Rights**

With the exception of rights expressly conferred in the Trust Agreement, nothing expressed or mentioned in or to be implied from the Trust Agreement or the Obligations is intended or shall be construed to give to any Person other than the parties to the Trust Agreement, the University, any Credit Support Provider and the Holders of the Obligations any legal or equitable right, remedy or claim under or in respect to the Trust Agreement or any covenants, conditions and provisions in contained in the Trust Agreement; the Trust Agreement and all of the covenants, conditions and provisions of the Trust Agreement being intended to be and being for the sole and exclusive benefit of the parties hereto, the University, any Credit Support Provider and the Holders of the Obligations as provided in the Trust Agreement. (Section 9.02)

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**EXHIBIT B**

**UNIVERSITY OF KENTUCKY**
**CONSOLIDATED FINANCIAL STATEMENTS AS OF JUNE 30, 2005**

**And**

**UNIVERSITY OF KENTUCKY**
**ALBERT B. CHANDLER MEDICAL CENTER**
**UNIVERSITY HOSPITAL**
**CONSOLIDATED FINANCIAL STATEMENTS AS OF JUNE 30, 2005**

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*University of Kentucky*

# Consolidated Financial Statements

# 2005


UNIVERSITY OF KENTUCKY

# University of Kentucky
# Consolidated Financial Statements
# Year Ended June 30, 2005

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## MESSAGE FROM THE PRESIDENT

When this university becomes a Top-20 public research university, school historians may very well identify 2004-05 as the year that catapulted the University of Kentucky into a higher academic stratosphere. UK made great strides toward fulfilling its Top-20 dreams during the past year. We educated more students and conducted more research, while our faculty and staff worked to improve lives across the Commonwealth.

Before we look ahead to the next fiscal year, I would like to touch upon some of last year's highlights.

**Support from Frankfort**

UK could not have reached new heights in 2004-05 without strong legislative support. The 2005 legislative session was the most favorable since I became President in 2001. Thanks to the Governor and bipartisan support in the legislature, the university is poised to move ahead with a number of projects that will lead our land-grant mission into the 21st century.

For the first time since I became President, we received additional operating funds to support our growth and expansion efforts.

We also received legislative approval for our new UK Hospital patient care facility project. The $375 million project, the largest in UK history, includes a new $250 million bed tower, as well as a $125 million facility renovation. The refurbished hospital will provide central and eastern Kentucky counties with the type of high-quality medical services that Kentucky needs. It also will provide the community with 1,600 jobs during the peak of construction and 1,300 permanent positions after completion. Most importantly, no state dollars will be used to finance the project.

One of the nation's 10 best pharmacy programs also received legislative support. The College of Pharmacy received $40 million in bonds for construction of a new pharmacy complex on campus. It was a positive first step for the pharmacy project, which, once completed, will make a major impact throughout Kentucky. Work force estimates indicate the need to

*President Lee T. Todd, Jr. addresses University faculty and staff outside Patterson Office Tower.*

increase pharmacy enrollment by 80 percent across the Commonwealth. Since 90 percent of UK pharmacy students are Kentuckians who hope to remain in the Commonwealth, this project will make an important impact throughout the state. We are hopeful Kentucky legislators will again support UK's nationally ranked pharmacy program during the 2006 General Assembly.

The Governor and legislature also supported our Livestock Disease Diagnostic Center, which will greatly benefit Kentucky's equine and cattle industries.

We were grateful for the legislative backing we received in 2004-05, and we are looking forward to the upcoming legislative session so we can build on last year's momentum.

**Enhancing Kentucky's Capacity for Learning**

The University of Kentucky's Top-20 mission starts in the classroom. And if our current crop of students is indicative of that mission, UK is on the right path.

Last year's entering class was the most competitive in school history. Our fall 2004 freshman class included a UK-record 3,987 students, 3,109 of whom are from Kentucky. The freshman class had 35 National Merit Scholars; two National Achievement Scholars; 275 Governor's Scholars, and 28 Governor's School for the Arts students. It also included 157 valedictorians.

Early projections of our 2005-06 class indicate UK is primed for another record year.

UK students continue to prove something that we have known for years: they are some of the best and brightest in the nation. Ryan Quarles of Georgetown, Kentucky, received the prestigious Harry S. Truman Scholarship in March, the 12th UK student to earn such an honor. He is the only student from a Kentucky institution to be named a Truman Scholar.

Nicholas Badre and Jason Passafiume became the seventh and eighth students chosen as Beckman Scholars since UK became a participating university in 2002. The Beckman Foundation renewed UK's participation for a second three-year period last month.

In an attempt to enhance undergraduate education, we created the Center for Undergraduate Excellence. The center established a cooperative environment to strengthen academic excellence at the university, bringing together such programs as the Honors Program, undergraduate research, study abroad, and a host of other initiatives.

**Enhancing Kentucky's Economy**

University of Kentucky Research set another record in 2004-05, bringing in $274 million in grants and contracts, a 15 percent increase over last year's then-record total of $238 million. UK also moved from 31st to 28th among all public universities for federal research expenditures, an important measure collected by the National Science Foundation.

UK's research enterprise makes a significant impact on this state's economy. It was estimated that externally supported research led to approximately 9,060 jobs in Kentucky in fiscal year 2004-05. It was also estimated that research from out-of-state sources contributed approximately $169.4 million in personal income to people in Kentucky. Each dollar of out-of-state external funding for research generates an additional 80 cents in indirect expenditures.

Our research enterprise – particularly our medical research – got a boost with the opening of the $75 million Biomedical Biological Sciences Research Building (BBSRB). Featuring an open-format design that will encourage collaborative research, the BBSRB will be home to 350-400 research faculty, staff and students who will concentrate on groundbreaking research in neuroscience, genomics and proteomics.

UK researchers are dedicated to conducting the type of research that will make an impact on Kentucky families. In May, we announced an initiative to help alleviate some of the nagging issues that have held Kentucky back called the Commonwealth Collaboratives. The plan calls for the university to conduct research and participate in projects to alleviate some of Kentucky's most pressing problems.

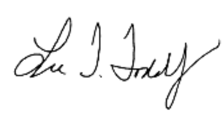
The Commonwealth Collaboratives will focus on four areas: health care, agriculture, education, and economic development. UK faculty and researchers will lead efforts to battle conditions in these areas to improve educational, social and economic conditions in all 120 Kentucky counties.

The Commonwealth Collaboratives are a clear illustration of the University of Kentucky's land-grant mission. UK is your university, Kentucky's university. And we need to play an integral role in helping Kentuckians solve their problems and realize their dreams.

UK must be a positive change agent in the Commonwealth. Through education, research and service, UK is wholly committed to becoming the type of Top-20 university the legislature demands and Kentuckians deserve.

On my first day as UK President I was asked what I hoped people would say about me on my last day on the job. I said if UK did more for the people of Kentucky than any other land-grant university of the nation, I would be satisfied.

That is still my hope today.



Lee T. Todd, Jr.
President

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## INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of the
University of Kentucky

and

the Secretary of Finance and Administration Cabinet Of The
Commonwealth of Kentucky

We have audited the accompanying consolidated statements of net assets of the University of Kentucky (the University) (an agency of the Commonwealth of Kentucky) and affiliated corporations as of June 30, 2005 and 2004, and the related consolidated statements of revenues, expenses and changes In net assets and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained In *Government Auditing Standards* Issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit Includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a teat basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the University of Kentucky and affiliated corporations as of June 30, 2005 and 2004, and their changes in net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 2 through 12 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the University's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

September 1, 2005

# Management's Discussion and Analysis

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of the University of Kentucky (the University) and its affiliated corporations for the years ended June 30, 2005 and 2004. Management has prepared this discussion, and we encourage you to read it in conjunction with the consolidated financial statements and the notes appearing in this report.

**About the University of Kentucky**

Located in Lexington, the University of Kentucky is the Commonwealth of Kentucky's flagship institution of higher education. As a land grant institution, the University is dedicated to enriching people's lives through excellence in teaching, research and service and plays a critical leadership role for the state by promoting human and economic development that improves lives within Kentucky's borders and beyond.

The University of Kentucky has a presence in all 120 counties – through its Agricultural Extension Service -- with an impact nationwide and abroad. Total enrollment is nearly 27,000 students, representing all Kentucky counties, every state in the nation, and 117 countries. In 2004 - 2005, the University conferred 6,272 degrees among its comprehensive academic programs. About 1,900 full-time faculty and 9,000 full-time staff are employed by the University.

The University consists of 16 colleges, plus the Graduate School. With 93 undergraduate programs, master's degrees in 99 fields, doctoral degrees in 66 programs, and four professional programs, the colleges include: Agriculture, Arts and Sciences, Business and Economics, Communications and Information Studies, Dentistry, Design, Education, Engineering, Fine Arts, Health Sciences, Law, Medicine, Nursing, Pharmacy, Public Health, and Social Work. The University boasts more than 80 national rankings for academic excellence.

The University's William T. Young Library is among the world's leading research libraries; its book endowment is the largest among public universities and ranks second only to Harvard University among all universities. Its broad scope of technology offers students, faculty and Kentucky residents access to the most up-to-date information from online journals, government publications, and private studies, as well as more traditional materials.

The UK Chandler Medical Center, which opened in 1960, is considered one of the nation's finest academic medical centers. The faculty, students and staff take pride in achieving excellence in education, patient care, research, and community service. As one of two Level 1 Trauma Centers in the state and the first health-care facility in Central and Eastern Kentucky to obtain distinction as a Primary Stroke Center, UK Hospital cares for the most critically injured and ill patients in the region. The 473-bed UK Hospital and UK Children's Hospital are supported by more than 500 faculty physicians and dentists, 400 resident physicians, and a staff of 3,200 health professionals committed to high-quality patient care.

Research at the University is a dynamic enterprise encompassing both traditional scholarship and emerging technologies. The Advanced Science and Technology Commercialization Center, for example, is a hub for multidisciplinary research collaboration. It is just one of more than 50 research centers and institutes across campus, including the highly acclaimed Sanders-Brown Center on Aging, Morris K. Udall Parkinson's Disease Research Center of Excellence, and Markey Cancer Center, where University researchers are discovering and developing new treatments to improve health care, providing a rich training ground for the next generation of researchers, and advancing the state's economic growth.

During fiscal year 2005, the University faculty received a record-breaking total of $274.0 million in extramural funding for grants and contracts. The achievement marked an increase of 15 percent from last fiscal year and the fourth year in a row the University exceeded the $200 million level in sponsored project awards.

The majority of grants and contracts – 56 percent – were awarded by federal agencies and totaled $152.2 million, an increase of 6 percent. Due to the University's improvement – from 31st to 28th among public research institutions – in the National Science Foundation's most recent rankings of federal spending obligations, the Commonwealth of Kentucky is now ranked 30th, up from 33rd.

The University is committed to strong public service, reaching out to communities across the Commonwealth, sharing knowledge and making a difference in the towns, cities, and lives of all Kentuckians. An example is Health Education through Extension Leadership, a partnership between the College of Public Health, the College of Dentistry, the College of Agriculture, and the Cooperative Extension Service to enhance extension agents' capacity to deliver valuable health and wellness information throughout the state.

The University's agenda is simple – to be a catalyst for a new Commonwealth, one that is healthier, more prosperous and economically secure and that educates the state's best and brightest. The University is accelerating the movement toward academic excellence, becoming known worldwide for the quality of its academic programs, its commitment to undergraduates, its success in building a diverse community, and its engagement with the larger society.

**Research Challenge Trust Fund**

In 1998, the Commonwealth of Kentucky initiated the Research Challenge Trust Fund (RCTF), an endowment match program. Since that time, the Commonwealth has appropriated more than $350 million to the public universities to be matched with private donations primarily to support chairs and professorships, fellowships and scholarships, and the research and graduate missions of the institutions. To date, the University of Kentucky has been allocated $202.2 million in RCTF funding.

**Financial Highlights**

The University's overall financial position remains strong with assets of $2.45 billion and liabilities of $582.0 million. Net assets, which represent the University's residual interest in assets after liabilities are deducted, were $1.86 billion or 76 percent of total assets.

- Total assets increased $137.7 million, or 6 percent, primarily due to increases in cash and cash equivalents, endowment investments and capital assets.

- Total liabilities increased $13.0 million, or 2 percent, primarily due to the issuance of new debt, offset by payments of current year principal maturities on bonds and capital lease obligations, and increases in self insurance reserves.

- Total net assets increased $124.7 million, or 7 percent, due to an increase in net capital assets of $13.3 million; an increase in restricted net assets of $49.9 million, primarily due to additions to endowments of $37.5 million and realized and unrealized gains on endowment investments of $26.7 million; and an increase of $61.4 million in unrestricted net assets, primarily due to excess revenues over expenses in the hospital and general funds.

- Operating revenues were $1.19 billion and operating expenses were $1.47 billion, resulting in a loss from operations of $281.2 million. Nonoperating revenues, including $287.9 million in state appropriations, net of nonoperating expenses, were $405.9 million, which, when combined with the loss from operations, resulted in an overall increase in net assets of $124.7 million.

**Using the Consolidated Financial Statements**

The University presents its financial reports in a "business type activity" format, in accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. In addition to this MD&A section, the financial report includes a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, a Statement of Cash Flows, and Notes to the Financial Statements. GASB requires that statements be presented on a consolidated basis to focus on the University as a whole.

**Reporting Entity**

The University of Kentucky is a component unit of the Commonwealth of Kentucky. The consolidated financial statements of the University include the operations of the University and the following entities:

- University of Kentucky Research Foundation, and its for-profit subsidiary, Kentucky Technology, Inc.
- University of Kentucky Athletic Association
- The Fund for Advancement of Education and Research in the University of Kentucky Medical Center
- University of Kentucky Business Partnership Foundation, Inc.
- University of Kentucky Center on Aging Foundation, Inc.
- University of Kentucky Gluck Equine Research Foundation, Inc.
- University of Kentucky Humanities Foundation, Inc.
- University of Kentucky Mining Engineering Foundation, Inc.
- Central Kentucky Management Services, Inc. (formerly Health Care Collection Service, Inc.)
- Kentucky Medical Services Foundation, Inc.
- Kentucky Healthcare Enterprises, Inc., a for-profit subsidiary.

**Consolidated Statement of Net Assets**

The Consolidated Statement of Net Assets is the University's balance sheet. It reflects the total assets, liabilities and net assets (equity) of the University as of June 30, 2005, with comparative information as of June 30, 2004. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Net assets, the difference between total assets and total liabilities, are an important indicator of the University's current financial condition, while the change in net assets is an indicator of whether the overall financial position has improved or worsened during the year. Generally, assets and liabilities are reported using current values. A major exception is capital assets, which are stated at historical cost, less accumulated depreciation. A summarized comparison of the University's assets, liabilities and net assets at June 30, 2005, 2004 and 2003 is as follows:

### ***Condensed Consolidated Statement of Net Assets (in thousands)***

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **ASSETS** | | | |
| Current assets | $ 542,273 | $ 480,985 | $ 481,649 |
| Capital assets, net of depreciation | 1,028,064 | 982,366 | 900,856 |
| Other noncurrent assets | 874,771 | 844,098 | 729,235 |
| Total Assets | 2,445,108 | 2,307,449 | 2,111,740 |
| **LIABILITIES** | | | |
| Current liabilities | 213,913 | 204,913 | 199,810 |
| Noncurrent liabilities | 368,039 | 364,059 | 273,774 |
| Total Liabilities | 581,952 | 568,972 | 473,584 |
| **NET ASSETS** | | | |
| Invested in capital assets, net of related debt | 750,485 | 737,140 | 680,056 |
| Restricted | | | |
| Nonexpendable | 394,090 | 356,599 | 330,973 |
| Expendable | 216,481 | 204,049 | 175,996 |
| Unrestricted | 502,100 | 440,689 | 451,131 |
| Total Net Assets | $ 1,863,156 | $ 1,738,477 | $ 1,638,156 |

***Assets.*** As of June 30, 2005, total assets amounted to $2.45 billion. Of this amount, investment in capital assets (net of depreciation) of $1.03 billion, or 42 percent of total assets, represented the largest asset class. Endowment assets amounted to $555.4 million or 23 percent of total assets and cash and cash equivalents amounted to $439.9 million or 18 percent of total assets. During the year, total assets increased by $137.7 million primarily due to increases in cash and cash equivalents, endowment investments and capital assets.

***Liabilities.*** As of June 30, 2005, total liabilities amounted to $582.0 million. Bonds payable and capital leases for educational buildings, the housing and dining system, the University hospital and the William T. Young library amounted to $331.0 million, or 57 percent of total liabilities. During the year, total liabilities increased by $13.0 million primarily due to the issuance of new capital debt, net of principal payments on bonds and capital lease obligations, and increases in self insurance reserves.

***Net Assets.*** The equity of the University of $1.86 billion as of June 30, 2005 is reported on the Statement of Net Assets in four net asset categories: invested in capital assets, net of related debt, $750.5 million (40 percent), restricted-nonexpendable, $394.1 million (21 percent), restricted-expendable, $216.5 million (12 percent), and unrestricted, $502.1 million (27 percent).

Restricted net assets are subject to externally imposed restrictions governing their use. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the unrestricted net assets have been internally designated for support of academic and research programs and initiatives, capital projects, and working capital requirements.

Total net assets increased by $124.7 million during the year ended June 30, 2005. Invested in capital assets, net of related debt, increased by $13.3 million, primarily due to net additions to capital assets of $123.9 million, offset by current year depreciation expense of $78.2 million. Restricted net assets increased by $49.9 million, primarily due to additions to permanent endowments of $37.5 million and realized and unrealized gains on endowment investments of $26.7 million. Unrestricted net assets increased $61.4 million, primarily due to revenues in excess of expenditures in hospital and general funds.

***2004 Versus 2003.*** During the year ended June 30, 2004:

- Total assets increased by $195.7 million, primarily due to increases in endowment investments and capital assets.

- Liabilities increased by $95.4 million primarily due to the issuance of new bonds, offset by payments of current year principal maturities on bonds and capital lease obligations.

- Total net assets increased by $100.3 million. Invested in capital, net of related debt, increased by $57.1 million, primarily due to net additions to capital assets of $152.4 million offset by current year depreciation expense of $70.9 million. Restricted net assets increased by $53.7 million, due to an increase in permanent endowments of $25.6 million, and an increase in expendable restricted net assets of $28.0 million, primarily due to an increase in realized and unrealized gains on endowment investments, offset by the expenditure of net assets restricted for capital projects. Unrestricted net assets decreased $10.4 million, primarily due to the expenditure of funds for capital assets.

**Consolidated Statement of Revenues, Expenses and Changes in Net Assets**

The Consolidated Statement of Revenues, Expenses and Changes in Net Assets is the University's income statement. It details how net assets have increased (or decreased) during the year ended June 30, 2005, with comparative information for the year ended June 30, 2004. This statement is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. All items that increase or decrease net assets must appear on the Consolidated Statement of Revenues, Expenses and Changes in Net Assets as revenues, expenses, gains or losses.

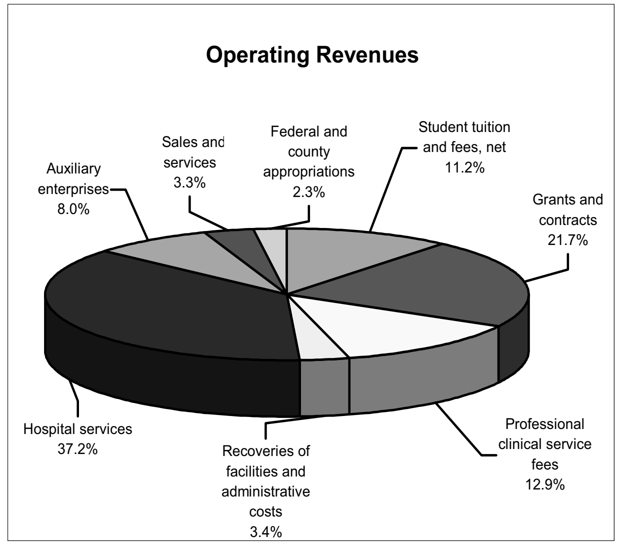
Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts, and investment and endowment income to be classified as nonoperating revenues. Accordingly, the University reports a net operating loss for the year prior to the addition of nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. Tuition revenue is reduced by gift scholarships and institutional aid, and is reported net of scholarship allowances in the financial statements. A summarized comparison of the University's revenues, expenses and changes in net assets for the years ended June 30, 2005, 2004 and 2003 is as follows:

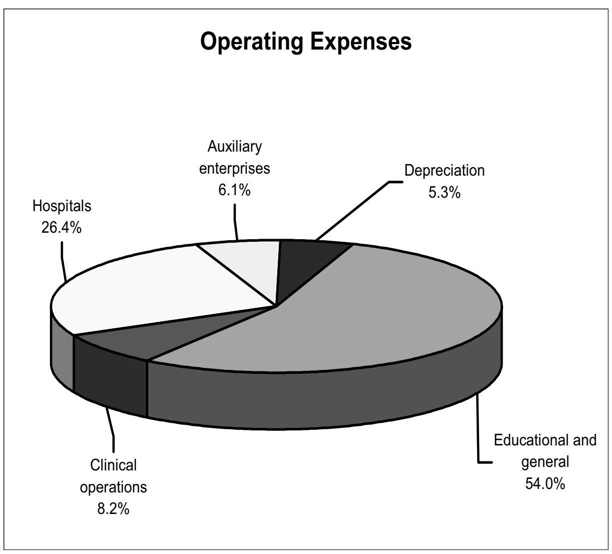
***Condensed Consolidated Statement of Revenues, Expenses and Changes in Net Assets***
***(in thousands)***

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **OPERATING REVENUES** | | | |
| Student tuition and fees, net of scholarship allowances | $ 133,389 | $ 124,034 | $ 107,485 |
| Grants and contracts | 257,896 | 234,092 | 212,920 |
| Hospital services | 440,609 | 370,628 | 343,393 |
| Professional clinical service fees | 152,477 | 141,989 | 131,451 |
| Auxiliary enterprises, net of scholarship allowances | 95,249 | 84,447 | 73,860 |
| Sales and services | 38,857 | 42,587 | 39,210 |
| Recoveries of facilities and administrative costs | 40,332 | 37,122 | 34,364 |
| Federal and county appropriations | 27,703 | 25,707 | 23,867 |
| Other operating revenue | 466 | 303 | 324 |
| Total operating revenues | 1,186,978 | 1,060,909 | 966,874 |
| **OPERATING EXPENSES** | | | |
| Educational and general, excluding depreciation | 793,746 | 787,780 | 751,083 |
| Clinical operations, excluding depreciation | 120,289 | 115,279 | 105,208 |
| Hospital, excluding depreciation | 387,685 | 329,142 | 296,375 |
| Auxiliary enterprises, excluding depreciation | 87,885 | 80,334 | 76,118 |
| Depreciation | 78,219 | 70,888 | 68,323 |
| Other | 381 | 276 | 223 |
| Total operating expenses | 1,468,205 | 1,383,699 | 1,297,330 |
| **OPERATING LOSS** | (281,227) | (322,790) | (330,456) |
| **NONOPERATING REVENUES (EXPENSES)** | | | |
| State appropriations | 287,897 | 302,539 | 304,735 |
| Capital appropriations | 732 | 2,070 | 1,660 |
| Capital grants and gifts | 18,915 | 15,275 | 20,005 |
| Gifts and grants | 24,638 | 22,477 | 19,721 |
| Investment income | 56,517 | 78,102 | 34,245 |
| Interest on capital asset - related debt | (13,062) | (11,970) | (11,487) |
| Additions to permanent endowments | 33,650 | 21,036 | 24,708 |
| Transfer of net assets of Lexington Community College | (4,968) | - | - |
| Other, net | 1,587 | (6,418) | 2,192 |
| Total nonoperating revenues (expenses) | 405,906 | 423,111 | 395,779 |
| Total increase in net assets | 124,679 | 100,321 | 65,323 |
| Net assets, beginning of year | 1,738,477 | 1,638,156 | 1,572,833 |
| Net assets, end of year | $ 1,863,156 | $ 1,738,477 | $ 1,638,156 |

Total operating revenues were $1.19 billion for the year ended June 30, 2005, an increase of $126.1 million (12 percent). The primary components were student tuition and fees of $133.4 million; grants, contracts and recoveries of facilities and administrative costs of $298.2 million; hospital services of $440.6 million; and professional clinical fee income of $152.5 million.

The major increases were in hospital services of $70.0 million due to a 12 percent increase in utilization and rate increases required to cover rising costs; in grants, contracts and recoveries of facilities and administrative costs of $27.0 million due to the continued expansion of the research mission of the University and a grant from the Commonwealth of Kentucky Department of Corrections related to prisoner health care; and in tuition and fees of $9.4 million due to tuition increases of approximately 14 percent and increased enrollment. Prior year numbers included Lexington Community College tuition revenue of $9.9 million.




Operating expenses totaled $1.47 billion, an increase of $84.5 million (6 percent). Of this amount, $793.7 million was expended for educational and general programs, including the functions of instruction, research and service. Hospital expenses, excluding depreciation, amounted to $387.7 million and clinical operations expenses, excluding depreciation, were $120.3 million. Depreciation expense for the year amounted to $78.2 million.

The most significant increase was in hospital expenses of $58.5 million (18 percent) due to increased usage of medical supplies and increased personnel costs due to higher utilization. The largest increase in educational and general expenses was in the public service area of $14.7 million (12 percent) due to the state grant mentioned above. Instruction expenses decreased $11.7 million (5 percent) due to the transfer of Lexington Community College, which had expenses of $14.3 million in the prior year, effective July 1, 2004.

The net loss from operations for the year amounted to $281.2 million. Nonoperating revenues, net of expenses, amounted to $405.9 million, resulting in an increase in net assets of $124.7 million for the year. Nonoperating revenues include state appropriations of $287.9 million, a decrease of $14.6 million due to the recurring transfer to the Kentucky Community and Technical College System for Lexington Community College and nonrecurring state budget reductions.

***2004 Versus 2003.*** Total operating revenues were $1.06 billion for the year ended June 30, 2004, including student tuition and fees of $124.0 million (12 percent), grants, contracts and recoveries of facilities and administrative costs of $271.2 million (26 percent), professional clinical service fees of $142.0 million (13 percent) and hospital services of $370.6 million (35 percent). Operating revenues for fiscal 2004 increased by $94.0 million or 10 percent over fiscal 2003, primarily due to increases in hospital services revenues of $27.2 million, in grants, contracts and recoveries of facilities and administrative costs of approximately $23.9 million and in student tuition and fees of $16.5 million.

Operating expenses totaled $1.38 billion. Of this amount, $787.8 million, or 57 percent, was expended for educational and general programs, including the functions of instruction, research and public service. Hospital expenses, excluding depreciation, amounted to $329.1 million, or 24 percent of the total expenses and clinical operations expenses, excluding depreciation, were $115.3 million, or 8 percent. Depreciation amounted to $70.9 million, or 5 percent. Operating expenses for fiscal 2004 increased by $86.4 million or 7 percent over fiscal 2003, primarily due to increases in hospital expenses of $32.8 million due to higher costs for medical supplies and personnel, and in educational and general expenses of $36.7 million.

The net loss from operations for the year amounted to $322.8 million. Nonoperating revenues, net of expenses, amounted to $423.1 million, resulting in an increase in net assets of $100.3 million for the year. This compares with an increase in net assets for fiscal 2003 of $65.3 million. The most significant difference between fiscal 2003 and 2004 was an increase in investment income of $43.9 million.

**Consolidated Statement of Cash Flows**

The Consolidated Statement of Cash Flows details how cash has increased (or decreased) during the year ended June 30, 2005, with comparative financial information for the year ended June 30, 2004. It breaks out the sources and uses of cash into the following categories:

- Operating activities
- Non-capital financing activities
- Capital financing activities
- Investing activities

Cash flows associated with the University's expendable net assets appear in the operating and non-capital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt, and debt repayments. Purchases and sales of investments are reflected in investing activities.

The primary purpose of the Consolidated Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the University during the year that will allow financial statement readers to assess the institution's:

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

A comparative summary of the University's consolidated statement of cash flows for the years ended June 30, 2005, 2004 and 2003 is as follows:

***Condensed Consolidated Statement of Cash Flows (in thousands)***

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **CASH PROVIDED (USED) BY:** | | | |
| Operating activities | $ (203,467) | $ (228,809) | $ (248,155) |
| Noncapital financing activities | 345,427 | 348,499 | 350,853 |
| Capital and related financing activities | (118,891) | (79,170) | (132,164) |
| Investing activities | 15,696 | (6,490) | 30,432 |
| Net increase in cash | 38,765 | 34,030 | 966 |
| **Cash and cash equivalents, beginning of year** | 401,090 | 367,060 | 366,094 |
| **Cash and cash equivalents, end of year** | $ 439,855 | $ 401,090 | $ 367,060 |

The University's cash and cash equivalents increased $38.8 million in 2005. Total cash provided by operating and non-capital financing activities was $142.0 million, up $22.3 million compared to 2004. Total cash used for capital financing activities was $118.9 million, reflecting both capital funding sources (debt proceeds) and uses (purchases of capital assets and debt service). Total cash provided by investing activities was $15.7 million, primarily due to interest and dividends on investments.

Major sources of cash received from operating activities are student tuition and fees of $133.4 million, hospital services of $441.3 million, and grants, contracts and recoveries of facilities and administrative costs of $299.1 million. Major uses of cash for operating activities were payments to employees for salaries and benefits of $810.4 million and to vendors and contractors of $548.7 million.

Noncapital financing activities includes state appropriations from the Commonwealth of Kentucky of $287.9 million.

Capital and related financing activities include proceeds of capital debt of $29.7 million and capital grants and gifts of $5.7 million. Cash of $112.9 million was expended for construction and acquisition of capital assets, $38.2 million was expended for principal and interest payments on debt, and $6.2 million was paid to refunding bond agents.

Investing activities include proceeds from sales and maturities of investments of $1.74 billion and interest and dividends on investments of $26.4 million. Cash of $1.75 billion was used to purchase investments.

***2004 Versus 2003.*** Cash balances improved when comparing fiscal 2004 versus fiscal 2003 with a net increase in cash of approximately $34.0 million. The net increase in cash was due primarily to the excess funding provided by the issuance of new debt over the actual expenditures made as of June 30, 2004.

**Capital Asset and Debt Administration**

**Capital Assets**

Capital assets, net of accumulated depreciation, totaled $1.03 billion at June 30, 2005, an increase of $45.7 million. Capital assets as of June 30, 2005, and significant changes in capital assets during the years ended June 30, 2005, and 2004 are as follows (in millions):

| | Balance June 30, 2003 | Net Additions FY 03-04 | Balance June 30, 2004 | Net Additions FY 04-05 | Balance June 30, 2005 |
|---|---|---|---|---|---|
| Land and land improvements | $ 89 | $ 3 | $ 92 | $ 6 | $ 98 |
| Buildings, fixed equipment and infrastructure | 1,057 | 60 | 1,117 | 93 | 1,210 |
| Equipment, vehicles and capitalized software | 347 | 30 | 377 | 24 | 401 |
| Library materials and art | 116 | 6 | 122 | 10 | 132 |
| Construction in progress | 63 | 26 | 89 | (34) | 55 |
| Accumulated depreciation | (771) | (44) | (815) | (53) | (868) |
| Total | $ 901 | $ 81 | $ 982 | $ 46 | $ 1,028 |

At June 30, 2005, the University has capital construction projects in progress totaling approximately $211 million in scope. Major projects include student housing facilities and new parking structures.

**Debt**

At June 30, 2005, capital debt amounted to $331.0 million, summarized by trust indenture and type as follows (in millions):

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Consolidated Educational Buildings Revenue Bonds | $ 141.6 | $ 154.3 | $ 114.1 |
| Housing and Dining System Revenue Bonds | 77.0 | 79.3 | 28.6 |
| Hospital Revenue Bonds | 1.8 | 3.8 | 3.8 |
| Commonwealth Library Project (W.T. Young Library) Bonds | 41.4 | 42.5 | 43.6 |
| Capital Lease Obligations | 66.1 | 43.1 | 45.0 |
| Notes Payable | 3.1 | 3.5 | 4.0 |
| Total | $ 331.0 | $ 326.5 | $ 239.1 |

Debt increased $4.5 million during the year primarily due to a capital lease for the purchase and implementation of the University's new administrative computing systems, offset by the payment of current year bond maturities.

**Economic Factors That Will Affect the Future**

Executive management believes that the University is well-positioned to maintain its strong financial condition and to continue providing excellent service to students, patients, the community and the Commonwealth of Kentucky. The University's strong financial condition, as evidenced by the receipt of a credit rating of Aa3 from Moody's Investors Service, will provide a high degree of flexibility in obtaining funds on competitive terms. This flexibility, along with ongoing efforts toward revenue diversification and cost containment, will enable the University to obtain the necessary resources to sustain excellence. The following are known facts and circumstances that will affect future financial results:

- As a result of an improving economy, budgeted state appropriations for fiscal year 2005-2006 will increase for the first time in five years to $314.3 million.
- Tuition rates for fiscal year 2006 will increase an average of approximately 12.5 percent for resident undergraduate students. The tuition rate increases combined with stable enrollment are expected to generate additional operating revenues of approximately $15.7 million.
- As of June 30, 2005, grants and contracts of approximately $182 million had been awarded to the University, but not expended. These contracts will provide grant revenue to future periods. Research grants and contracts awarded to the University in fiscal year 2005 were a record high of $274.0 million.
- The University is conducting its Campaign for the University of Kentucky, a capital campaign with an expanded goal of $1 billion. Approximately $790 million of gifts have been received or pledged toward this goal.
- A new patient care facility with an estimated construction project cost of $375 million has been approved by the General Assembly, with $100 million in related bond authority approved for the current biennium.
- The University will continue its long-term endowment investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to insulate programs funded by the endowment from temporary market volatility.
- The University does not record a liability for post-employment retiree health benefits. Governmental Accounting Standards require that this liability be recognized in the financial statements beginning June 30, 2008. The University has not completed its evaluation of the impact that the adoption of this statement will have on its financial statements, but it is likely to be significant.

Economic challenges will continue to impact the future. However, university management believes that the University of Kentucky will be able to sustain its sound financial position and continue its progress to become one of America's 20 best public research institutions.

**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS**
**CONSOLIDATED STATEMENT OF NET ASSETS**
**JUNE 30, 2005 AND 2004**

| | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 364,986,832 | $ 307,848,379 |
| Notes, loans and accounts receivable, net | 126,763,191 | 115,502,281 |
| Investments | 29,846,815 | 38,644,220 |
| Inventories and other | 20,675,672 | 18,990,178 |
| Total current assets | 542,272,510 | 480,985,058 |
| **Noncurrent Assets** | | |
| Restricted cash and cash equivalents | 74,868,400 | 93,242,027 |
| Endowment investments | 555,365,026 | 511,928,739 |
| Other long-term investments | 213,472,794 | 208,484,085 |
| Notes, loans and accounts receivable, net | 31,065,483 | 30,443,232 |
| Capital assets, net | 1,028,063,986 | 982,365,781 |
| Total noncurrent assets | 1,902,835,689 | 1,826,463,864 |
| Total assets | 2,445,108,199 | 2,307,448,922 |
| **LIABILITIES** | | |
| **Current Liabilities** | | |
| Accounts payable and accrued liabilities | 118,076,210 | 115,314,338 |
| Deferred revenue | 48,375,374 | 46,950,552 |
| Long-term liabilities - current portion | 47,460,973 | 42,647,990 |
| Total current liabilities | 213,912,557 | 204,912,880 |
| **Noncurrent Liabilities** | | |
| Long-term liabilities | 368,039,152 | 364,059,493 |
| Total liabilities | 581,951,709 | 568,972,373 |
| **NET ASSETS** | | |
| **Invested in capital assets, net of related debt** | 750,484,801 | 737,139,956 |
| **Restricted** | | |
| Nonexpendable | | |
| Scholarships and fellowships | 75,713,970 | 68,374,267 |
| Research | 175,871,180 | 153,906,008 |
| Instruction | 58,992,583 | 54,902,750 |
| Academic support | 78,979,700 | 74,926,996 |
| Other | 4,533,052 | 4,488,822 |
| Total restricted nonexpendable | 394,090,485 | 356,598,843 |
| Expendable (See note 9.) | | |
| Scholarships and fellowships | 48,218,520 | 48,192,927 |
| Research | 44,296,031 | 39,284,399 |
| Instruction | 41,575,014 | 41,883,500 |
| Academic support | 22,198,641 | 17,535,578 |
| Loans | 8,726,094 | 8,283,332 |
| Capital projects | 9,563,760 | 10,622,979 |
| Debt service | 4,747,705 | 6,570,210 |
| Other | 37,155,201 | 31,676,231 |
| Total restricted expendable | 216,480,966 | 204,049,156 |
| Total restricted | 610,571,451 | 560,647,999 |
| **Unrestricted** (See note 10.) | 502,100,238 | 440,688,594 |
| Total net assets | $ 1,863,156,490 | $ 1,738,476,549 |



See notes to consolidated financial statements.

**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS**
**CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**
**FOR THE YEARS ENDED JUNE 30, 2005 AND 2004**

| | 2005 | 2004 |
|---|---|---|
| **OPERATING REVENUES** | | |
| Student tuition and fees, including pledged revenues | $ 178,587,240 | $ 170,018,037 |
| Less: Scholarship allowances | (45,198,300) | (45,983,729) |
| Net tuition and fees | 133,388,940 | 124,034,308 |
| Federal grants and contracts | 139,634,182 | 134,207,554 |
| State and local grants and contracts | 88,148,206 | 70,043,579 |
| Nongovernmental grants and contracts | 30,113,297 | 29,840,995 |
| Recoveries of facilities and administrative costs | 40,332,490 | 37,122,226 |
| Sales and services | 38,856,761 | 42,586,715 |
| Federal appropriations | 16,135,899 | 15,622,978 |
| County appropriations | 11,567,197 | 10,083,679 |
| Professional clinical service fees | 152,476,528 | 141,988,915 |
| Hospital services, including pledged revenues | 440,609,478 | 370,627,540 |
| Auxiliary enterprises: | | |
| Housing and dining, including pledged revenues | 36,359,880 | 36,224,731 |
| Less: Scholarship allowances | (4,217,608) | (6,296,085) |
| Net housing and dining | 32,142,272 | 29,928,646 |
| Athletics | 42,408,397 | 42,970,474 |
| Other auxiliaries | 20,698,585 | 11,548,258 |
| Other operating revenues | 465,610 | 302,761 |
| Total operating revenues | 1,186,977,842 | 1,060,908,628 |
| **OPERATING EXPENSES** | | |
| Educational and general: | | |
| Instruction | 235,308,851 | 247,011,317 |
| Research | 219,952,120 | 208,557,422 |
| Public service | 136,549,884 | 121,887,133 |
| Libraries | 13,440,593 | 13,609,420 |
| Academic support | 41,052,291 | 45,686,079 |
| Student services | 18,704,843 | 20,431,888 |
| Institutional support | 53,994,323 | 51,501,518 |
| Operations and maintenance of plant | 45,577,213 | 47,351,021 |
| Student financial aid | 29,165,814 | 31,743,647 |
| Depreciation | 53,528,499 | 50,273,283 |
| Total educational and general | 847,274,431 | 838,052,728 |
| Clinical operations (including depreciation of $726,210 in 2005 and $718,796 in 2004) | 121,015,048 | 115,998,394 |
| Hospital and clinics (including depreciation of $19,265,277 in 2005 and $15,192,132 in 2004) | 406,949,935 | 344,334,389 |
| Auxiliary enterprises: | | |
| Housing and Dining (including depreciation of $2,183,203 in 2005 and $2,148,480 in 2004) | 34,092,645 | 34,369,705 |
| Athletics (including depreciation of $2,515,907 in 2005 and $2,555,741 in 2004) | 44,472,780 | 42,995,953 |
| Other auxiliaries | 14,017,792 | 7,672,281 |
| Other operating expenses | 381,985 | 276,185 |
| Total operating expenses | 1,468,204,616 | 1,383,699,635 |
| Net loss from operations | (281,226,774) | (322,791,007) |
| **NONOPERATING REVENUES (EXPENSES)** | | |
| State appropriations | 287,897,256 | 302,538,956 |
| Gifts and grants | 24,638,487 | 22,476,900 |
| Investment income | 56,517,381 | 78,101,981 |
| Interest on capital asset-related debt | (13,062,343) | (11,969,667) |
| Other nonoperating revenues and expenses, net | 3,343,018 | 3,916,951 |
| Net nonoperating revenues (expenses) | 359,333,799 | 395,065,121 |
| Net gain (loss) before other revenues, expenses, gains, or losses | 78,107,025 | 72,274,114 |
| Capital appropriations | 732,166 | 2,070,472 |
| Capital grants and gifts | 18,915,305 | 15,275,331 |
| Additions to permanent endowments, including Research Challenge Trust Funds of $14,519,692 in 2005 and $1,864,197 in 2004 | 33,650,404 | 21,035,538 |
| Transfer of net assets of Lexington Community College | (4,968,447) | - |
| Other, net | (1,756,512) | (10,334,660) |
| Total other revenues (expenses) | 46,572,916 | 28,046,681 |
| **INCREASE IN NET ASSETS** | 124,679,941 | 100,320,795 |
| **NET ASSETS, beginning of year** | 1,738,476,549 | 1,638,155,754 |
| **NET ASSETS, end of year** | $ 1,863,156,490 | $ 1,738,476,549 |

See notes to consolidated financial statements.

**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS**
**CONSOLIDATED STATEMENT OF CASH FLOWS**
**FOR THE YEARS ENDED JUNE 30, 2005 AND 2004**

| | 2005 | 2004 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Student tuition and fees | $ 133,441,920 | $ 123,841,597 |
| Grants and contracts | 258,728,281 | 234,600,486 |
| Recoveries of facilities and administrative costs | 40,344,165 | 37,167,131 |
| Sales and services | 38,667,103 | 42,539,769 |
| Federal appropriations | 15,724,706 | 15,527,585 |
| County appropriations | 11,089,895 | 10,292,606 |
| Payments to vendors and contractors | (548,680,341) | (496,536,773) |
| Student financial aid | (29,178,203) | (31,707,371) |
| Salaries, wages and benefits | (810,390,049) | (777,649,684) |
| Professional clinic service fees | 149,498,425 | 143,921,021 |
| Hospital services | 441,273,315 | 376,173,834 |
| Auxiliary enterprise receipts: | | |
| Housing and Dining | 32,062,046 | 30,293,831 |
| Athletics | 41,574,832 | 42,282,589 |
| Other auxiliaries | 20,479,035 | 11,917,023 |
| Loans issued to students | (13,313,757) | (11,756,427) |
| Collection of loans to students | 13,359,946 | 9,940,975 |
| Self insurance receipts | 32,957,622 | 34,735,703 |
| Self insurance payments | (32,046,168) | (30,128,712) |
| Other receipts (payments), net | 939,603 | 5,735,798 |
| Net cash provided (used) by operating activities | (203,467,624) | (228,809,019) |
| **CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES** | | |
| State appropriations | 287,897,256 | 302,538,956 |
| Gifts and grants received for other than capital purposes: | | |
| Gifts received for endowment purposes | 33,650,404 | 21,035,538 |
| Gifts received for other purposes | 25,612,601 | 20,710,103 |
| Agency and loan program receipts | 91,343,086 | 84,046,990 |
| Agency and loan program payments | (96,238,768) | (83,998,854) |
| Other nonoperating receipts (payments), net | 3,162,632 | 4,166,804 |
| Net cash provided (used) by noncapital financing activities | 345,427,211 | 348,499,537 |
| **CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | |
| Capital appropriations | (4) | 547,021 |
| Capital grants and gifts | 5,681,344 | 7,294,205 |
| Purchases of capital assets | (112,885,265) | (149,595,685) |
| Proceeds from capital debt | 29,651,354 | 185,689,095 |
| Payments to refunding bond agents | (6,174,849) | (86,736,986) |
| Proceeds from sales of capital assets | 10,089 | 238,749 |
| Principal paid on capital debt and leases | (25,106,312) | (23,392,879) |
| Interest paid on capital debt and leases | (13,057,633) | (11,556,729) |
| Other capital and related financing receipts (payments), net | 2,990,256 | (1,656,327) |
| Net cash provided (used) by capital and related financing activities | (118,891,020) | (79,169,536) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Proceeds from sales and maturities of investments | 1,736,561,278 | 1,665,952,773 |
| Interest and dividends on investments | 26,415,348 | 22,275,312 |
| Purchase of investments | (1,747,280,367) | (1,694,718,508) |
| Net cash provided (used) by investing activities | 15,696,259 | (6,490,423) |
| **NET INCREASE IN CASH** | 38,764,826 | 34,030,559 |
| **CASH AND CASH EQUIVALENTS, beginning of year** | 401,090,406 | 367,059,847 |
| **CASH AND CASH EQUIVALENTS, end of year** | $ 439,855,232 | $ 401,090,406 |
| **Reconciliation of net loss from operations to net cash used by operating activities:** | | |
| Operating loss | $ (281,226,774) | $ (322,791,007) |
| Adjustments to reconcile net loss to net cash used by operating activities: | | |
| Depreciation expense | 78,219,096 | 70,888,432 |
| Change in assets and liabilities: | | |
| Notes, loans and accounts receivable, net | (6,912,821) | 5,992,813 |
| Inventories and other assets | (1,460,218) | (2,064,424) |
| Accounts payable and accrued liabilities | 1,549,214 | 7,859,203 |
| Deferred revenue | 2,148,691 | 5,444,662 |
| Long term liabilities | 4,215,188 | 5,861,302 |
| **Net cash used by operating activities** | $ (203,467,624) | $ (228,809,019) |



See notes to consolidated financial statements.

# UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Reporting Entity**
The University of Kentucky (the University) is a component unit of the Commonwealth of Kentucky and is included in the basic financial statements of the Commonwealth. The consolidated financial statements of the University include the operations of the University, its for-profit subsidiary (Kentucky Healthcare Enterprise, Inc.) and its affiliated non-profit corporations (entities for which the University is financially accountable as defined by Statement No. 14 and amended by Statement No. 39 of the Governmental Accounting Standards Board) as follows: The University of Kentucky Research Foundation and its for-profit subsidiary (Kentucky Technology, Inc.); The Fund for Advancement of Education and Research in the University of Kentucky Medical Center; University of Kentucky Athletic Association; Central Kentucky Management Services, Inc. (formerly Health Care Collection Service, Inc.); University of Kentucky Mining Engineering Foundation, Inc.; University of Kentucky Business Partnership Foundation, Inc.; University of Kentucky Gluck Equine Research Foundation, Inc.; University of Kentucky Humanities Foundation, Inc.; University of Kentucky Center on Aging Foundation, Inc.; and Kentucky Medical Services Foundation, Inc.

**Basis of Presentation**
The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net assets categories:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:
  *Nonexpendable* – Net assets subject to externally imposed stipulations that they be maintained permanently by the University. Such assets include the principal of the University's permanent endowment funds.

  *Expendable* – Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.

- Unrestricted: Net assets whose use by the University is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

**Summary of Significant Accounting Policies**

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

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

Noncurrent cash and cash equivalents includes plant funds allocated for capital projects and endowment fund cash pending transfer to the custodian for investment. Cash and cash equivalents held by the University's endowment fund managers are included in endowment investments.

Inventories. Inventories are stated principally at the lower of average cost or market.

Pooled Endowment Funds. The University employs the total return concept of investment management for setting investment objectives and determining investment performance. This concept recognizes dividends and interest, plus or minus realized and unrealized gains or losses, in determining the total return earned during any particular period. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

The Uniform Management of Institutional Funds Act (UMIFA), as adopted by the Commonwealth of Kentucky, permits the University to appropriate an amount of the realized and unrealized endowment appreciation to support current programs. Accordingly, spendable return from the endowment is determined using the total return philosophy. This philosophy recognizes a prudent amount of realized and unrealized gains as spendable return in addition to traditional yield. Distribution of investment earnings for expenditure by participating funds is supported first by traditional yield earned and, if necessary, a transfer from the endowment of any prior years' accumulated earnings (unexpended traditional yield) or net realized or unrealized gains. The University's endowment spending rule provides for an annual distribution of 5 percent of the three-year moving average market value of fund units. For the years ended June 30, 2005 and 2004 approximately $11,481,000 and $16,114,000, respectively, was transferred from endowment realized and unrealized gains to support current programs in accordance with the University's endowment spending rule. Appreciation on endowments available to support future spending rule distributions amounted to approximately $98,026,000 at June 30, 2005.

The Investment Committee of the University's Board of Trustees has approved spending rate distributions of 4.75 percent and 4.50 percent for fiscal years 2005-06 and 2006-07, respectively, of the three-year moving average market value of fund units. Additionally, the University assesses eligible endowment accounts with a management fee to support fundraising and endowment administration. The management fee was 1 percent of total asset value during the years ended June 30, 2005 and 2004. The Investment Committee has approved a management fee of .75 percent and .50 percent of total asset value for fiscal years 2005-06 and 2006-07, respectively.

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

Capital Assets. Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift.

Equipment with a unit cost of $2,000 or more ($1,000 for computers) and having an estimated useful life of greater than one year, is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings, 10 – 25 years for land and building improvements and infrastructure, 10 years for library books and 5 – 20 years for equipment.

The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research and public service.

Deferred Revenue. Deferred revenue consists primarily of amounts received from grant and contract sponsors that have not yet been earned under the terms of the agreement. Deferred revenue also includes amounts received in advance of an event, such as advance athletic ticket sales relating to future fiscal years and unearned summer school revenue.

Student Tuition and Fees. Student tuition and fees are presented net of scholarship allowances applied to student accounts. Stipends and other payments made directly to students are presented as student financial aid expenses.

Hospital and Clinical Services Revenues. Hospital and clinical services revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including contractual allowances and estimated retroactive adjustments under reimbursement programs with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Income Taxes. The University is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.100 through 164.280. Accordingly, the University is excluded from Federal income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986. The majority of the University's affiliated non-profit organizations have received a determination from the Internal Revenue Service granting exemption from federal income taxation pursuant to the provisions of Internal Revenue Code section 501(c)(3).

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

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

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

Recent Accounting Pronouncements. In June 2004, the GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions." This statement establishes standards for the measurement, recognition and display of other postemployment benefit expenses/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of employers subject to governmental accounting standards. The provisions of this statement are effective for financial statements for fiscal periods beginning after December 15, 2006. The University has not yet completed its evaluation of the impact that the adoption of this statement will have on its financial statements, but it is likely to be significant.

## 2. RESEARCH CHALLENGE TRUST FUND

The Research Challenge Trust Fund (RCTF) was created by the Kentucky General Assembly with the passage of the Postsecondary Education Improvement Act of 1997 (House Bill 1). The objectives of the Trust Fund, as stated in the Bill, include support of efforts by the University of Kentucky to attain status as a top-20 public research university. The RCTF Endowment Match Program provides state funds on a dollar-for-dollar match basis. This program, also known as “Bucks for Brains”, supports endowed chairs, professorships and graduate fellowships, and the research and graduate mission of the University.

The status of the RCTF endowed funds as of June 30, 2005, is summarized as follows (in thousands):

| | Kentucky General Assembly Funding | University of Kentucky Share of Funding | State Funds Received to Date | Matching Pledges Receivable |
|---|---|---|---|---|
| 1998 Biennium | $ 100,000 | $ 66,667 | $ 66,667 | |
| 2000 Biennium | 100,000 | 68,857 | 68,857 | $ 6,982 |
| 2002 Biennium | 100,000 | 66,667 | 16,333 | 6,282 |
| Total | $ 300,000 | $ 202,191 | $ 151,857 | $ 13,264 |

Interest income of approximately $2.2 million earned on the state matching funds is included in the University’s share of the 2000 Biennium funding.

The University expects to fully realize all outstanding matching pledges, however, it may be obligated to return any state funds and accrued interest income related to pledges not received within five years of the initial pledge dates if unable to replace the unpaid pledges with other eligible gifts. A payment schedule of the outstanding pledges is shown below (in thousands):

| | 2000 Biennium | 2002 Biennium |
|---|---|---|
| Pledges due in fiscal years 2005 or prior | $ 536 | $ 395 |
| Pledges due in fiscal year 2006 | 5,541 | 1,351 |
| Pledges due in fiscal year 2007 | 763 | 1,479 |
| Pledges due in fiscal year 2008 | 112 | 1,533 |
| Pledges due in fiscal year 2009 | 30 | 964 |
| Pledges due in fiscal year 2010 | - | 560 |
| Total | $ 6,982 | $ 6,282 |

## 3. DEPOSITS AND INVESTMENTS

The fair value and cost of deposits and investments, by type, at June 30, 2005 and 2004 are as follows (in thousands):

| | 2005 | |
|---|---|---|
| | Fair Value | Cost |
| Deposits with banks and the Commonwealth of Kentucky | $ 43,465 | $ 43,465 |
| United States government fixed income securities | 112,086 | 111,542 |
| Common and preferred stocks | 56,339 | 51,552 |
| Pooled equity funds | 334,238 | 284,841 |
| Pooled real estate funds | 42,504 | 40,378 |
| Pooled fixed income funds | 448,723 | 447,358 |
| Corporate fixed income securities | 28,573 | 27,820 |
| Guaranteed investment contracts | 41,712 | 41,670 |
| Repurchase agreements | 66,728 | 66,728 |
| Equity in healthcare corporations | 31,379 | 31,379 |
| Certificates of deposit | 27,810 | 27,794 |
| Cash and cash equivalents | 4,835 | 4,835 |
| Other | 148 | 148 |
| Total | $ 1,238,540 | $ 1,179,510 |

| | 2004 | |
|---|---|---|
| | Fair Value | Cost |
| Deposits with banks and the Commonwealth of Kentucky | $ 20,676 | $ 20,676 |
| United States government fixed income securities | 109,736 | 110,225 |
| Common and preferred stocks | 228,910 | 199,210 |
| Pooled equity funds | 154,860 | 112,433 |
| Pooled fixed income funds | 426,602 | 427,416 |
| Corporate fixed income securities | 27,221 | 27,533 |
| Guaranteed investment contracts | 40,734 | 40,621 |
| Repurchase agreements | 86,425 | 86,425 |
| Equity in healthcare corporations | 30,313 | 30,313 |
| Certificates of deposit | 21,761 | 21,761 |
| Cash and cash equivalents | 12,377 | 12,409 |
| Other | 532 | 532 |
| Total | $ 1,160,147 | $ 1,089,554 |

| | 2005 | 2004 |
|---|---|---|
| Statement of Net Assets classification | | |
| Cash and cash equivalents | $ 364,987 | $ 307,848 |
| Current investments | 29,847 | 38,644 |
| Restricted cash and cash equivalents | 74,868 | 93,242 |
| Endowment investments | 555,365 | 511,929 |
| Other long-term investments | 213,473 | 208,484 |
| Total | $ 1,238,540 | $ 1,160,147 |

Included above in the caption "Equity in healthcare corporations" is the University's approximately 84 percent ownership of CHA Service Company (CHA), a Kentucky for-profit corporation established to provide an integrated health care delivery system throughout the Commonwealth of Kentucky. The University accounts for its investment in CHA by the equity method since, under the provision of CHA's by-laws, the University cannot exercise control over the day-to-day operations of CHA. A summary of the University's investment in CHA is as follows (in thousands):

| | June 30, 2003 | Fiscal 2003-04 | June 30, 2004 | Fiscal 2004-05 | June 30, 2005 |
|---|---|---|---|---|---|
| Capital investment | $ 38,180 | | $38,180 | | $38,180 |
| Equity in income (losses) through December 31, 2003 and 2004 (CHA fiscal year end) | (2,934) | $ (6,177) | (9,111) | $ 1,226 | (7,885) |
| Net investment | $ 35,246 | $ (6,177) | $29,069 | $ 1,226 | $30,295 |

The University's equity in the net income of CHA for the six months ended June 30, 2005 was approximately $3.8 million (unaudited). This income is not reflected in the University's consolidated financial statements as of June 30, 2005.

**Deposit and investment policies.** The University's Board of Trustees is responsible for establishing deposit and investment policies. Once established, the Board has delegated day-to-day management to the Treasurer of the University, who is also the Treasurer of the Board. Deposit and investment policies are developed to insure compliance with state laws and regulations as well as to establish and maintain sound financial management practices.

The University follows Kentucky Revised Statutes (KRS 42.500) for the investment of public funds, which list allowable investment instruments to include: obligations of the United States or a United States government agency; obligations of any corporation of the United States Government; collateralized certificates of deposit; highly rated uncollateralized certificates of deposit, bankers acceptances and commercial paper; highly rated securities issued by a state or local government; and mutual funds comprised of any of the above allowable investments.

For purposes of investment management, the majority of the University's deposits and investments can be grouped into five significant categories, as follows:

- Overnight investments (deposits and repurchase agreements) with local banks and the Commonwealth of Kentucky;

- Bond revenue fund investments held by the Treasurer of the Commonwealth of Kentucky as required by the University's bond trust indentures, and invested in pooled fixed income funds managed by the Commonwealth of Kentucky;
- Short term investments managed by the University, including individual securities purchased and held by the University and short term investments in pooled fixed income funds managed by the Commonwealth of Kentucky;
- Debt service reserve fund investments required by the University's bond trust indentures and held by the bond trustee;
- Endowment investments administered by the University and managed using external investment managers.

The Treasurer manages the overnight and short term investment programs of the University based on the Statement of Investment Objectives and Policies for Short-Term Current Funds Investments established by the Investment Committee of the University's Board of Trustees.

The University's policy for the investment of bond revenue and debt service reserve funds is governed by each respective bond's trust indenture.

The Investment Committee of the University's Board of Trustees establishes and maintains the University's Endowment Investment Policy.

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

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

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

- Overnight investment (deposits and repurchase agreements) policies minimize credit risk in several ways. Deposits are governed by State law which requires full collateralization. Credit risk on repurchase agreements with local banks is mitigated by the issuing financial institution's pledge of specific U.S. treasury or agency securities, held in the name of the University by the Federal Reserve Bank. Credit risk on repurchase agreements with the Commonwealth of Kentucky is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth.
- Bond revenue fund investments held in the Commonwealth's investment pools can invest in U.S. treasuries and agencies; commercial paper or asset backed securities rated in the highest category by a nationally recognized rating agency; certificates of deposit, bankers acceptances, state or local government securities and corporate, Yankee and Eurodollar securities rated in one of the three highest categories by a nationally recognized rating agency; shares of mutual funds (up to 10%); and state and local property tax certificates of delinquency secured by interests in real estate.
- Short-term investments managed by the University are limited to direct obligations of the U.S. Treasury, other appropriate securities issued by federal agencies, repurchase agreements of U.S. government obligations, and certificates of deposit collateralized by U.S. government obligations or general obligations of the University of Kentucky. Short term investments held in the Commonwealth's investment pools are subject to the same credit quality requirements as denoted above for bond revenue fund investments.
- Investment securities held in bond debt service reserve funds may be invested and reinvested solely in bonds or interest bearing notes of the United States Government.
- Endowment investments held by fixed income managers are generally limited to holdings of high quality fixed income securities. These managers may invest a portion of the portfolio in other below-investment grade bonds, non U.S. dollar denominated bonds, and emerging market bonds, provided the overall credit quality of the fixed income portfolios is not lower than A-.

The credit quality of the University's fixed income investments as of June 30, 2005, is as follows (in thousands):

| | S&P/Moody's Credit Ratings | | | |
|---|---|---|---|---|
| | AAA/Aaa | A | BBB/Baa | Not rated |
| U.S. government fixed income | $ 77,201 | | | |
| Corporate fixed income | 11,587 | $ 1,021 | $ 15,964 | |
| Fixed income pools | | | | $ 446,366 |
| Repurchase agreements | | | | 66,728 |
| Cash equivalents | 4,316 | | | |
| Total fixed income securities | $ 93,104 | $ 1,021 | $ 15,964 | $ 513,094 |

***Custodial Credit Risk.*** Custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investment or collateral securities that are in possession of an outside party.

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

- Overnight investments (deposits and repurchase agreements) are not exposed to custodial credit risk other than repurchase agreements with the Commonwealth of Kentucky which are held in the Commonwealth's name.
- Bond revenue fund investments and short term investments held in the Commonwealth's investment pools are held in the Commonwealth's name by the Commonwealth's custodian.
- Short term investments managed by the University are held in the University's name by the University's custodian.
- Investment securities held in bond debt service reserve funds are held by the respective bond trustee in a specific trust account for the benefit of the University and bondholders.
- Endowment investments are held in the University's name by the University's custodian.

At June 30, 2005, the following University deposit and investment balances held in the name of the Commonwealth of Kentucky were exposed to custodial credit risk as follows (in thousands):

| | State Deposits | Overnight Investments | Bond Revenue Investments | Short-term Investments | Other State Investments | Total |
|---|---|---|---|---|---|---|
| Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the University's name | $ 28,617 | $ 62,000 | | | | $ 90,617 |
| Uninsured, not registered in the name of the University and held by the counterparty but not in the University's name | | | $ 305,815 | $ 59,558 | $ 23,847 | 389,220 |
| Total | $ 28,617 | $ 62,000 | $ 305,815 | $ 59,558 | $ 23,847 | $ 479,837 |

***Concentrations of Credit Risk.*** University investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer.

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

- Overnight investments (deposits and repurchase agreements) are not limited as to the maximum amount that may be invested in one issuer. However, all such investments in excess of Federal Depository Insurance are required to be fully collateralized by U.S. treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- Bond revenue fund investments and short-term investments held in the Commonwealth's investment pools are limited as follows: U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers shall not exceed twenty-five (25) per cent of an individual pool and $25,000,000 per issuer, inclusive of commercial paper, bankers' acceptances and certificates of deposit; and U. S. dollar denominated sovereign debt shall not exceed five (5) per cent of any individual portfolio and $25,000,000 per issuer.
- There is no specific limit on the maximum amount of short term investments managed by the University that may be invested in one issuer. However, such investments are limited to direct U.S. government obligations (U.S. Treasuries) and U.S. government agencies.
- There is no specific limit on the maximum amount of investment securities held in bond debt service reserve funds that may be invested in one issuer. However, such investments are limited to bonds or interest bearing notes of the U.S. government.
- Endowment investment managers are limited to a maximum investment in any one issuer of no more than 5% of total investments.

At June 30, 2005, the University has no investments in any one issuer, other than U.S. treasury and/or agency securities, that represent 5 percent or more of total investments.

***Interest Rate Risk.*** Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Overnight investments (deposits and repurchase agreements) have limited exposure to interest rate risk due to the short term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Bond revenue fund investments and short-term investments held in the Commonwealth's short term investment pool are limited to a duration that does not exceed 90 days. Such investments in the Commonwealth's intermediate-term investment pool must maintain a modified duration of less than 3 years.
- Short term investments managed by the University are limited to a maximum maturity of 24 months.
- Investment securities held in bond debt service reserve funds are required to have a maturity no later than two years from the date of the investment.
- Endowment investments held by fixed income managers are limited to a duration that is within +/-25% of the duration of the Lehman Aggregate Bond Index.

At June 30, 2005, the University had the following investments managed based on maturities (in thousands):

| | | Maturities in Years | |
|---|---|---|---|
| Investment Type | Fair Value | Less than 1 | 1 - 5 |
| U.S. government fixed income | $ 54,733 | $ 37,783 | $ 16,950 |
| Guaranteed investment contracts | 29,560 | 29,560 | |
| Repurchase agreements | 66,728 | 66,728 | |
| Cash equivalents | 5,259 | 5,259 | |
| Total | $ 156,280 | $ 139,330 | $ 16,950 |

At June 30, 2005, the University had the following investments managed based on duration (in thousands):

| Investment Type | Fair Value | Modified Duration (Years) |
|---|---|---|
| U.S. government fixed income | | |
| Pooled endowment fund | $ 29,884 | 3.73 |
| Corporate fixed income | | |
| Pooled endowment fund | 28,573 | 3.68 |
| Fixed income pools | | |
| Pooled endowment fund | 57,146 | 4.04 |
| Commonwealth of Kentucky intermediate pool | 263,075 | 1.32 |
| Commonwealth of Kentucky short term pool | 126,145 | 0.04 |
| Total | $ 504,823 | |

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

The University's exposure to foreign currency risk derives from certain limited endowment investments, including pooled fixed income funds, a pooled global equity fund, and a pooled non-U.S. equity fund. The University's endowment investment policy allows fixed-income managers to invest a portion of their funds in non-U.S. securities and equity fund managers of co-mingled portfolios to invest in accordance with the guidelines established in the individual fund's prospectus.

At June 30, 2005, the following endowment investments were subject to foreign currency risk (in thousands):

| Endowment Investment | Fair Value |
|---|---|
| Pooled fixed income funds | $ 6,047 |
| Pooled global equity fund | 44,095 |
| Pooled non-U.S. equity fund | 62,163 |
| | $ 112,305 |

## 4. NOTES, LOANS AND ACCOUNTS RECEIVABLE

Notes, loans and accounts receivable as of June 30, 2005 and 2004, respectively, are as follows (in thousands):

| | 2005 | | |
|---|---|---|---|
| | Gross Receivable | Allowance | Net Receivable |
| Hospital patient accounts | $ 63,199 | $ (12,611) | $ 50,588 |
| KMSF patient accounts | 30,003 | (10,894) | 19,109 |
| Student loans | 27,213 | (2,760) | 24,453 |
| Reimbursement receivable - grants and contracts | 29,066 | - | 29,066 |
| Pledges receivable | 15,768 | (5,986) | 9,782 |
| Accrued interest receivable | 3,214 | - | 3,214 |
| Student receivables | 8,426 | (4,388) | 4,038 |
| Other | 19,133 | (1,555) | 17,578 |
| Total | $ 196,022 | $ (38,194) | $ 157,828 |
| Current portion | | | $ 126,763 |
| Non-current portion | | | 31,065 |
| Total | | | $ 157,828 |

| | 2004 | | |
|---|---|---|---|
| | Gross Receivable | Allowance | Net Receivable |
| Hospital patient accounts | $ 62,185 | $ (14,269) | $ 47,916 |
| KMSF patient accounts | 24,974 | (9,665) | 15,309 |
| Student loans | 27,571 | (3,050) | 24,521 |
| Reimbursement receivable - grants and contracts | 29,330 | - | 29,330 |
| Pledges receivable | 14,846 | (5,856) | 8,990 |
| Accrued interest receivable | 2,011 | - | 2,011 |
| Student receivables | 8,404 | (2,785) | 5,619 |
| Other | 13,554 | (1,305) | 12,249 |
| Total | $ 182,875 | $ (36,930) | $ 145,945 |
| Current portion | | | $ 115,502 |
| Non-current portion | | | 30,443 |
| Total | | | $ 145,945 |

## 5. CAPITAL ASSETS, NET

Capital assets as of June 30, 2005, and capital asset activity for the year ended June 30, 2005, are summarized as follows (in thousands):

| | June 30, 2004 | Additions | Deletions | June 30, 2005 |
|---|---|---|---|---|
| Land | $ 39,258 | $ 811 | $ 510 | $ 39,559 |
| Land improvements - nonexhaustible | 8,048 | 5,080 | - | 13,128 |
| Land improvements - exhaustible | 44,375 | 1,412 | - | 45,787 |
| Buildings | 1,048,919 | 76,407 | - | 1,125,326 |
| Fixed equipment - communications | 32,953 | 7,300 | - | 40,253 |
| Infrastructure | 34,799 | 9,980 | - | 44,779 |
| Equipment | 345,853 | 31,064 | 25,038 | 351,879 |
| Vehicles | 16,549 | 1,827 | 677 | 17,699 |
| Library materials | 115,698 | 4,605 | 1,447 | 118,856 |
| Nondepreciable library materials | - | 5,947 | - | 5,947 |
| Capitalized software | 14,254 | 17,211 | - | 31,465 |
| Art | 6,893 | 76 | - | 6,969 |
| Construction in progress | 89,562 | 42,281 | 77,041 | 54,802 |
| | 1,797,161 | 204,001 | 104,713 | 1,896,449 |
| <u>Accumulated Depreciation</u> | | | | |
| Land improvements - exhaustible | 38,193 | 1,648 | - | 39,841 |
| Buildings | 436,829 | 28,115 | - | 464,944 |
| Fixed equipment - communications | 18,366 | 2,670 | - | 21,036 |
| Infrastructure | 6,742 | 1,592 | - | 8,334 |
| Equipment | 216,747 | 34,188 | 23,200 | 227,735 |
| Vehicles | 12,118 | 1,515 | 630 | 13,003 |
| Library materials | 85,568 | 5,459 | 799 | 90,228 |
| Capitalized software | 232 | 3,032 | - | 3,264 |
| | 814,795 | 78,219 | 24,629 | 868,385 |
| Capital assets, net | $ 982,366 | $ 125,782 | $ 80,084 | $ 1,028,064 |

Capital assets as of June 30, 2004, and capital asset activity for the year ended June 30, 2004, are summarized as follows (in thousands):

| | June 30, 2003 | Additions | Deletions | June 30, 2004 |
|---|---|---|---|---|
| Land | $ 38,896 | $ 1,286 | $ 924 | $ 39,258 |
| Land improvements - nonexhaustible | 7,172 | 876 | - | 8,048 |
| Land improvements - exhaustible | 43,596 | 779 | - | 44,375 |
| Buildings | 992,925 | 58,537 | 2,543 | 1,048,919 |
| Fixed equipment - communications | 30,066 | 2,887 | - | 32,953 |
| Infrastructure | 33,471 | 1,328 | - | 34,799 |
| Equipment | 322,017 | 50,025 | 26,189 | 345,853 |
| Vehicles | 16,201 | 1,124 | 776 | 16,549 |
| Library materials | 109,285 | 7,037 | 624 | 115,698 |
| Capitalized software | 8,573 | 5,681 | - | 14,254 |
| Art | 6,793 | 100 | - | 6,893 |
| Construction in progress | 62,409 | 59,564 | 32,411 | 89,562 |
| | 1,671,404 | 189,224 | 63,467 | 1,797,161 |
| Accumulated Depreciation | | | | |
| Land improvements - exhaustible | 36,661 | 1,532 | - | 38,193 |
| Buildings | 410,882 | 26,654 | 707 | 436,829 |
| Fixed equipment - communications | 16,093 | 2,273 | - | 18,366 |
| Infrastructure | 5,378 | 1,364 | - | 6,742 |
| Equipment | 210,291 | 31,679 | 25,223 | 216,747 |
| Vehicles | 11,355 | 1,474 | 711 | 12,118 |
| Library materials | 79,888 | 5,680 | - | 85,568 |
| Capitalized software | - | 232 | - | 232 |
| | 770,548 | 70,888 | 26,641 | 814,795 |
| Capital assets, net | $ 900,856 | $ 118,336 | $ 36,826 | $ 982,366 |

At June 30, 2005, the University has construction projects in process totaling approximately $211 million in scope. The estimated cost to complete these projects is approximately $156 million. Such construction is principally financed by proceeds from bonds.

The University has utilized capital leases to acquire various items of equipment costing approximately $22.2 million. Additionally, the University has entered into capital lease agreements with the State Property and Buildings Commission to finance renovations to Commonwealth Stadium and for the construction of several educational buildings. The University has also utilized a capital lease to fund the purchase and implementation of its new administrative computing systems.

## 6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2005 and 2004, respectively, are as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Payable to vendors and contractors | $ 53,083 | $ 48,476 |
| Accrued expenses, including vacation and sick leave | 44,974 | 41,706 |
| Employee withholdings and deposits payable to third parties | 20,019 | 25,132 |
| Total | $ 118,076 | $ 115,314 |

## 7. DEFERRED REVENUE

Deferred revenue as of June 30, 2005 and 2004, respectively, is as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Unearned summer school revenue | $ 4,692 | $ 4,383 |
| Unearned hospital revenue | 9,644 | 8,501 |
| Unearned grants and contracts revenue | 20,744 | 20,836 |
| Prepaid athletic ticket sales | 8,245 | 9,058 |
| Unearned state deferred maintenance pool funds | 475 | 1,207 |
| Other | 4,575 | 2,966 |
| Total | $ 48,375 | $ 46,951 |

## 8. LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2005, and long-term liability activity for the year ended June 30, 2005, are summarized as follows (in thousands):

| | June 30, 2004 | Additions | Reductions | June 30, 2005 | Current Portion | Noncurrent Portion |
|---|---|---|---|---|---|---|
| Bonds, notes and capital leases | | | | | | |
| Educational buildings bonds | $ 154,325 | | $ 12,760 | $ 141,565 | $ 13,610 | $ 127,955 |
| Housing and dining bonds | 79,275 | $ 6,230 | 8,450 | 77,055 | 3,055 | 74,000 |
| Hospital bonds | 3,850 | - | 2,080 | 1,770 | 1,770 | - |
| Library bonds | 42,520 | - | 1,105 | 41,415 | 1,165 | 40,250 |
| Capital leases | 43,086 | 29,700 | 6,709 | 66,077 | 5,003 | 61,074 |
| Notes payable | 3,485 | 3,062 | 3,443 | 3,104 | 2,713 | 391 |
| Total bonds, notes and capital leases | 326,541 | 38,992 | 34,547 | 330,986 | 27,316 | 303,670 |
| Other liabilities | | | | | | |
| Medical malpractice | 25,960 | 5,004 | 3,000 | 27,964 | 3,205 | 24,759 |
| Long term disability | 11,607 | 1,739 | 2,886 | 10,460 | 1,934 | 8,526 |
| Annuities payable | 5,646 | 231 | 186 | 5,691 | 494 | 5,197 |
| Health insurance | 5,455 | 25,224 | 22,065 | 8,614 | 8,614 | - |
| Federal loan programs | 21,414 | 1,346 | 920 | 21,840 | - | 21,840 |
| Workers compensation | 5,677 | 1,395 | 2,837 | 4,235 | 3,542 | 693 |
| Mining and Minerals Trust | 55 | - | - | 55 | 55 | - |
| Compensated absences | 2,750 | 250 | - | 3,000 | 454 | 2,546 |
| Supplemental disability | 608 | 57 | 323 | 342 | 195 | 147 |
| Arbitrage rebate | 278 | 191 | 104 | 365 | 64 | 301 |
| Outstanding check liability | 413 | 450 | 413 | 450 | 450 | - |
| Unemployment compensation | 303 | 612 | 496 | 419 | 419 | - |
| Other | - | 1,079 | - | 1,079 | 719 | 360 |
| Total other liabilities | 80,166 | 37,578 | 33,230 | 84,514 | 20,145 | 64,369 |
| Total | $ 406,707 | $ 76,570 | $ 67,777 | $ 415,500 | $ 47,461 | $ 368,039 |

Long-term liabilities as of June 30, 2004, and long-term liability activity for the year ended June 30, 2004, are summarized as follows (in thousands):

| | June 30, 2003 | Additions | Reductions | June 30, 2004 | Current Portion | Noncurrent Portion |
|---|---|---|---|---|---|---|
| Bonds, notes and capital leases | | | | | | |
| Educational buildings bonds | $ 114,100 | $ 128,375 | $ 88,150 | $ 154,325 | $ 12,760 | $ 141,565 |
| Housing and dining bonds | 28,621 | 57,050 | 6,396 | 79,275 | 2,640 | 76,635 |
| Hospital bonds | 3,850 | - | - | 3,850 | 2,080 | 1,770 |
| Library bonds | 43,565 | - | 1,045 | 42,520 | 1,105 | 41,415 |
| Capital leases | 45,013 | 4,950 | 6,877 | 43,086 | 5,146 | 37,940 |
| Notes payable | 3,979 | 915 | 1,409 | 3,485 | 3,063 | 422 |
| Total bonds, notes and capital leases | 239,128 | 191,290 | 103,877 | 326,541 | 26,794 | 299,747 |
| Other liabilities | | | | | | |
| Medical malpractice | 24,783 | 3,846 | 2,669 | 25,960 | 3,315 | 22,645 |
| Long term disability | 10,774 | 3,719 | 2,886 | 11,607 | 2,170 | 9,437 |
| Annuities payable | 5,298 | 980 | 632 | 5,646 | 686 | 4,960 |
| Health insurance | 3,821 | 22,259 | 20,625 | 5,455 | 5,455 | - |
| Federal loan programs | 20,767 | 647 | - | 21,414 | - | 21,414 |
| Workers compensation | 4,827 | 4,268 | 3,418 | 5,677 | 2,767 | 2,910 |
| Mining and Minerals Trust | 604 | - | 549 | 55 | - | 55 |
| Compensated absences | 2,500 | 250 | - | 2,750 | 417 | 2,333 |
| Supplemental disability | 367 | 446 | 205 | 608 | 328 | 280 |
| Arbitrage rebate | 1,862 | - | 1,584 | 278 | - | 278 |
| Outstanding check liability | 374 | 413 | 374 | 413 | 413 | - |
| Unemployment compensation | 113 | 953 | 763 | 303 | 303 | - |
| Total other liabilities | 76,090 | 37,781 | 33,705 | 80,166 | 15,854 | 64,312 |
| Total | $ 315,218 | $ 229,071 | $ 137,582 | $ 406,707 | $ 42,648 | $ 364,059 |

Principal maturities and interest on bonds, notes and capital leases for the next five years and in subsequent five-year periods as of June 30, 2005, are as follows (in thousands):

| | Principal | Interest | Total |
|---|---|---|---|
| 2006 | $ 27,316 | $ 13,217 | $ 40,533 |
| 2007 | 28,565 | 12,360 | 40,925 |
| 2008 | 25,336 | 11,464 | 36,800 |
| 2009 | 25,380 | 10,632 | 36,012 |
| 2010 | 17,916 | 9,777 | 27,693 |
| 2011 - 2015 | 77,683 | 39,169 | 116,852 |
| 2016 - 2020 | 79,136 | 22,742 | 101,878 |
| 2021 - 2025 | 49,654 | 5,809 | 55,463 |
| Total | $ 330,986 | $ 125,170 | $ 456,156 |

At June 30, 2005, assets with a fair market value of approximately $55,530,000 have been placed on deposit with trustees to totally defease bonds with a par amount of $53,475,000. The liability for these fully defeased bonds is not included in the financial statements.

On December 14, 2004, $6,230,000 of Housing and Dining Refunding Revenue Bonds Series P and Q (Second Series) were issued at a net interest cost of 3.657 percent, representing a full refunding of the original $2,140,000 Housing and Dining Series P, dated April 1, 1996 and a full refunding of the original $6,645,000 Housing and Dining Series Q, dated May 1, 1997. The refunding defeased $1,215,000 Series P bonds and $4,540,000 Series Q bonds outstanding as of June 1, 2005. The refunding will decrease the University's total debt service payments over the next 20 years by $365,399, representing an economic gain (difference between the present value of the debt service payments on the old and new debt) of $299,918.

## 9. COMPONENTS OF RESTRICTED EXPENDABLE NET ASSETS

Restricted expendable net assets are subject to externally imposed stipulations or conditions that must be followed and cannot be used for support of general operations of the University. At June 30, 2005 and 2004, respectively, restricted expendable net assets were composed of the following (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Appreciation on permanent endowments | $ 73,770 | $ 62,219 |
| Term endowments | 5,655 | 5,718 |
| Quasi-endowments initially funded with restricted assets | 43,525 | 45,998 |
| Funds restricted for capital purposes | 14,311 | 17,193 |
| Funds restricted for non-capital purposes | 70,494 | 64,638 |
| Loan funds (primarily University funds required for Federal match) | 8,726 | 8,283 |
| Total | $ 216,481 | $ 204,049 |

## 10. DESIGNATIONS OF UNRESTRICTED NET ASSETS

Unrestricted net assets are designated for specific purposes by action of the Board of Trustees or management or may otherwise be limited by contractual agreements. Commitments for the use of unrestricted net assets at June 30, 2005 and 2004, respectively, are as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Working capital requirements | $ 54,447 | $ 40,317 |
| Budget appropriations for future year fiscal operations | 27,057 | 27,018 |
| Designated for capital projects | 60,079 | 49,589 |
| Designated for renewal and replacement of capital assets | 169,265 | 170,172 |
| Hospital | 125,263 | 92,892 |
| Affiliated corporations | 65,989 | 60,701 |
| Total | $ 502,100 | $ 440,689 |

## 11. PLEDGED REVENUES

Certain revenues reflected in the Statement of Revenues, Expenses and Changes in Net Assets for the years ended June 30, 2005 and 2004, are pledged as security for the University's outstanding bonds, as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Student tuition and fees, pledged as collateral for the University's Consolidated Educational Buildings Revenue Bonds | $ 178,587 | $ 170,018 |
| Housing and Dining system revenues, pledged as collateral for the University's Housing and Dining System Revenue Bonds | $ 24,021 | $ 24,329 |
| Hospital patient services revenue, pledged as collateral for University's Hospital Revenue Bonds | $ 441,935 | $ 371,982 |

## 12. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2005 and 2004 are as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Interest and dividends earned on endowment investments | $ 11,294 | $ 7,105 |
| Realized and unrealized gains and losses on endowment investments | 26,742 | 67,103 |
| Interest and dividends on cash and non-endowment investments | 16,101 | 9,694 |
| Realized and unrealized gains and losses on non-endowment investments | 1,503 | (6,568) |
| Investment income from external trusts | 877 | 768 |
| Total | $ 56,517 | $ 78,102 |

## 13. FUNDS HELD IN TRUST BY OTHERS

The University is the income beneficiary of various trusts that are held and controlled by independent trustees. For the years ended June 30, 2005 and 2004, the University received income from these trusts of approximately $877,000 and $768,000, respectively. The market value of the external trust assets as of June 30, 2005 and 2004 was approximately $40,950,000 and $37,762,000, respectively. However, as the University does not have ownership of the trust assets held by external trustees, the trusts are recorded at a nominal value of $1 each.

## 14. PLEDGES AND DEFERRED GIFTS

At June 30, 2005, pledges totaling approximately $35,797,000 are expected to be collected primarily over the next five years, as follows (in thousands):

| | |
|---|---|
| Operating purposes | $ 3,975 |
| Capital projects | 14,349 |
| Endowment principal | 17,473 |
| Total | $ 35,797 |

In accordance with GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions," the University is required to record operating and capital pledges as revenue when all eligibility requirements have been met. Endowment pledges are not recognized as revenue until the gifts are actually received. Accordingly, for the years ended June 30, 2005 and 2004, the University recorded the discounted value of operating and capital pledges, net of the allowance for uncollectible pledges, of approximately $9,782,000 and $8,990,000, respectively.

Deferred gifts through insurance, known bequests and irrevocable trusts in which the University has a remainder interest are estimated to be approximately $57,302,000 at June 30, 2005. The University records these amounts as revenue when the cash is received.

## 15. GRANTS AND CONTRACTS AWARDED

At June 30, 2005, grants and contracts of approximately $182 million had been awarded to the University and the University of Kentucky Research Foundation but not expended. These amounts will be recognized in future periods.

## 16. PENSION PLANS

Regular full-time employees, including faculty, are participants in the University of Kentucky Retirement Plan, a defined contribution plan. The University of Kentucky Retirement Plan consists of five groups as follows:

| | |
|---|---|
| Group I | Established July 1, 1964, for faculty and certain administrative officials. |
| Group II | Established July 1, 1971, for staff members in the clerical, technical and service categories. |
| Group III | Established July 1, 1972, for staff members in the managerial, professional and scientific categories. |
| Group IV | Established January 1, 1973, for staff members having U.S. Civil Service retirement entitlement. |
| Group V | Established July 1, 1987, for staff members covered under the Federal Employees Retirement System that replaced Civil Service (those whose employment began during the period from January 1, 1984 to March 31, 1987). Staff members whose employment began after March 31, 1987 are under one of the above University of Kentucky Retirement Plans. |

Participation in the University of Kentucky Retirement Plan is mandatory for all regular full-time employees in groups I, II and III who are age 30 or older. Participation is voluntary for regular full-time employees under the age of 30 and for those employees in groups IV and V. Participants in groups I, II, III and IV contribute 5 percent and the University contributes 10 percent of the participant's eligible compensation to the retirement plan. Participants in group V contribute 1 percent and the University contributes 2 percent of the participant's eligible compensation to the retirement plan.

The University has authorized three retirement plan carriers, as follows:

Teachers Insurance and Annuity Association/College
Retirement Equities Fund (TIAA/CREF)
Fidelity Institutional Services Company
American Century Investments

Under the fully funded University of Kentucky Retirement Plan, the University and plan participants make contributions to provide fully vested retirement benefits to employees in individually owned contracts. The University's contributions and costs for 2005 and 2004 were approximately $51,702,000 and $49,597,000, respectively. Employees contributed approximately $25,626,000 in 2005 and $24,574,000 in 2004. The University's total payroll costs were approximately $730,380,000 and $701,427,000, respectively, for the years ended June 30, 2005 and 2004. The payroll for employees covered by the retirement plan was approximately $517,025,000 and $495,973,000 for 2005 and 2004, respectively.

In addition to retirement benefits provided from the group retirement plan, the University provides supplemental retirement income benefits to certain eligible employees in each of the retirement groups (see Note 17).

## 17. MINIMUM ANNUAL RETIREMENT BENEFITS AND SUPPLEMENTAL RETIREMENT INCOME

Employees in retirement groups I, II and III, referred to in Note 16, who were age 40 or older prior to the date of establishment of each group plan, and who were employed by the University prior to that date, qualify for the minimum annual retirement benefit provisions of the retirement plan. Benefits for these eligible employees are based upon a percentage, determined through years of service, of the participant's annual salary in the last year of employment prior to retirement. Retirement benefits as determined are funded by each individual retiree's accumulation in the group retirement plan, with the balance, if necessary, provided by the University as supplemental retirement income.

The Legislature of the Commonwealth of Kentucky has appropriated funds to the University for the payment of supplemental retirement income benefits since adoption of the group retirement plans, and is expected to continue this practice. However, the Constitution of the Commonwealth of Kentucky prohibits the commitment of future revenues beyond the end of the current biennium. Accordingly, the University does not recognize the liability for supplemental retirement income benefits during the service life of covered employees, but recognizes its costs when funds are appropriated by the Legislature and payments are made. The University intends to continue paying supplemental retirement income benefits contingent upon the Legislature continuing to appropriate funds required to make these payments. Supplemental retirement benefit payments were approximately $3,460,000 and $3,680,000 for the years ended June 30, 2005 and 2004, respectively.

The latest actuarial valuation was prepared as of June 30, 2004, by TIAA. The actuarial present value of accumulated supplemental retirement income benefits as determined by this valuation, utilizing an assumed rate of return of 7 percent, was $21,934,000.

## 18. HEALTH INSURANCE BENEFITS FOR RETIREES

The University provides a health care credit towards health insurance coverage to retirees who have a minimum of fifteen years service. The University recognizes the cost of providing this credit by expensing the credit in the year provided. These health care credits totaled approximately $7,311,000 and $6,708,000 for the years ended June 30, 2005 and 2004, respectively. At June 30, 2005, there were 2,348 retirees who met the service requirement and were receiving the health care credit.

## 19. RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims, or (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance, participation in insurance risk retention groups or self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and most other causes of loss between $500 and $500,000 per occurrence. Losses in excess of $500,000 are insured by commercial carriers up to $500 million per occurrence principally on an actual cash value basis. As a state agency, the University is vested with Sovereign Immunity and is subject to the provisions of the Board of Claims Act, under which the University's liability for certain negligence claims is limited to $200,000 for any one person or $350,000 for all persons damaged by a single act of negligence. Claims against educators' errors and omissions and wrongful acts are insured through a reciprocal risk retention group. There have been no significant reductions in insurance coverage from 2004 to 2005. Settlements have not exceeded insurance coverage during the past three years.

The University and its agents are insured against medical malpractice by a combination of Sovereign Immunity, self-insurance, commercial liability insurance, and an excess coverage fund established by the Commonwealth of Kentucky. The malpractice liability at June 30, 2005, is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be recorded if it is probable that a liability has occurred and the amount of loss can be reasonably estimated. The liability includes an estimate for claims that have been incurred but not reported at June 30, 2005.

The University is self-insured for the long-term disability income program and has established a 501(c)(9) trust for purposes of paying claims and establishing necessary reserves. The estimated long-term disability payments for known claims at June 30, 2005 are reported at their present value assuming an investment yield of 6 percent.

The University also self-insures certain employee benefits, including health insurance, worker's compensation, unemployment claims, and a long-term disability supplemental reserve, to the extent not covered by insurance. The University has recorded an estimate for asserted claims at June 30, 2005.

Long-term liabilities related to self-insurance are detailed in Note 8, above.

## 20. CONTINGENCIES

The University is defendant in various lawsuits. However, University officials are of the opinion, based on advice of in-house legal counsel, that the effect of the ultimate outcome of all litigation will not be material to the future operations or financial position of the University.

**21. NATURAL CLASSIFICATION**

The University's operating expenses by natural classification were as follows for the years ended June 30, 2005 and 2004, respectively (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Salaries and wages | $ 665,604 | $ 637,653 |
| Employee benefits | 164,016 | 156,718 |
| Repairs and maintenance | 65,461 | 68,471 |
| Supplies | 165,894 | 157,283 |
| Depreciation | 78,219 | 70,888 |
| Student scholarships and financial aid | 38,531 | 37,795 |
| Utilities | 50,255 | 47,363 |
| Communications | 17,912 | 17,753 |
| Professional services | 94,802 | 70,294 |
| Travel | 13,743 | 12,789 |
| Resale | 9,297 | 9,468 |
| Other, various | 104,471 | 97,225 |
| Total | $ 1,468,205 | $ 1,383,700 |

**22. TRANSFER OF LEXINGTON COMMUNITY COLLEGE**

The General Assembly of the Commonwealth of Kentucky during the 2004 Regular Session enacted House Joint Resolution 214. The resolution directed the University of Kentucky Board of Trustees to delegate the governance and management responsibilities for the Lexington Community College (LCC) to the Kentucky Community and Technical College System (KCTCS) on or before July 1, 2004. Effective on July 1, 2004, the transition was completed and a memorandum of agreement for transfer was implemented. The following assets, liabilities, and net assets of LCC were transferred to KCTCS effective July 1, 2004 (in thousands):

| | |
|---|---|
| Assets | $ 6,116 |
| Liabilities | $ 1,148 |
| Net Assets | $ 4,968 |

These amounts are included in the University of Kentucky consolidated financial statements as of June 30, 2004.

**23. RECLASSIFICATIONS**

Certain reclassifications to fiscal 2004 comparative amounts have been made to conform with the 2005 classifications.

**24. SUBSEQUENT EVENTS**

On August 2, 2005, the University sold $11,495,000 of University of Kentucky Consolidated Educational Buildings Revenue Bonds, Series U, at a net interest cost of 4.13%. The proceeds of the bond issue will be used to complete the construction of several parking garages and to provide funding for several infrastructure projects on the main campus in Lexington, Kentucky.

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# INDEPENDENT AUDITORS' REPORT ON ADDITIONAL INFORMATION

To the Board of Trustees of the
University of Kentucky

and

the Secretary of Finance and
Administration Cabinet of the
Commonwealth of Kentucky

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The additional consolidating information contained on pages 39 and 40 is presented for the purpose of additional analysis and is not a required part of the basic consolidated financial statements. This additional information is the responsibility of the University's management. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic consolidated financial statements taken as a whole.

Deloitte & Touche LLP

September 1, 2005

**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS**
**CONSOLIDATING SCHEDULE**
**STATEMENT OF NET ASSETS**
**JUNE 30, 2005**
**(in thousands)**

| | UK | UK Research Foundation | The Fund | Gluck Equine Research Foundation | UK Athletic Association | Humanities Foundation | Mining Engineering Foundation | Business Partnership Foundation | Center on Aging | Central Kentucky Management Services | Kentucky Medical Services Foundation | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | | | | | |
| **Current Assets** | | | | | | | | | | | | |
| Cash and cash equivalents | $ 338,496 | $ 8 | $ 8,666 | $ 1,325 | $ 11,495 | $ 80 | $ 7 | $ 423 | $ 190 | $ 208 | $ 4,089 | $ 364,987 |
| Notes, loans and accounts receivable, net | 73,873 | 32,220 | 1,677 | | 258 | 24 | | 2 | | | 18,709 | 126,763 |
| Investments | | | | | | | | | | | 29,847 | 29,847 |
| Inventories and other | 16,093 | 1,762 | | | 2,683 | | | | | 9 | 129 | 20,676 |
| Total current assets | 428,462 | 33,990 | 10,343 | 1,325 | 14,436 | 104 | 7 | 425 | 190 | 217 | 52,774 | 542,273 |
| **Noncurrent Assets** | | | | | | | | | | | | |
| Restricted cash and cash equivalents | 74,826 | | | | | | 42 | | | | | 74,868 |
| Endowment investments | 526,389 | 4,024 | 214 | 8,432 | 297 | 1,242 | 1,776 | 12,991 | | | | 555,365 |
| Other long-term investments | 191,027 | 368 | | | 3,176 | | | | | | 18,902 | 213,473 |
| Notes, loans and accounts receivable, net | 30,595 | | | | | 44 | | 26 | | | 400 | 31,065 |
| Capital assets, net | 958,723 | 4,271 | | | 51,217 | | | | | 235 | 13,618 | 1,028,064 |
| Total noncurrent assets | 1,781,560 | 8,663 | 214 | 8,432 | 54,690 | 1,286 | 1,818 | 13,017 | - | 235 | 32,920 | 1,902,835 |
| Total assets | 2,210,022 | 42,653 | 10,557 | 9,757 | 69,126 | 1,390 | 1,825 | 13,442 | 190 | 452 | 85,694 | 2,445,108 |
| **LIABILITIES** | | | | | | | | | | | | |
| **Current Liabilities** | | | | | | | | | | | | |
| Accounts payable and accrued liabilities | 103,118 | 7,855 | 133 | | 2,262 | | | 6 | | 217 | 4,485 | 118,076 |
| Deferred revenue | 18,647 | 21,484 | | | 8,245 | | | | | | | 48,376 |
| Long-term liabilities - current portion | 42,864 | | | | 1,165 | | | | | | 3,432 | 47,461 |
| Total current liabilities | 164,629 | 29,339 | 133 | - | 11,672 | - | - | 6 | - | 217 | 7,917 | 213,913 |
| **Noncurrent Liabilities** | | | | | | | | | | | | |
| Long-term liabilities | 327,038 | | | | 40,250 | | | | | | 751 | 368,039 |
| Total liabilities | 491,667 | 29,339 | 133 | - | 51,922 | - | - | 6 | - | 217 | 8,668 | 581,952 |
| **INTERFUND BALANCES** | 18,502 | (1,430) | (717) | (3) | (171) | | | | | | (16,181) | - |
| **NET ASSETS** | | | | | | | | | | | | |
| **Invested in capital assets, net of related debt** | 722,488 | 4,270 | | | 12,978 | | | | | 235 | 10,514 | 750,485 |
| **Restricted** | | | | | | | | | | | | |
| Nonexpendable | 379,594 | 1,131 | 31 | 4,676 | | 640 | 625 | 7,393 | | | | 394,090 |
| Expendable | 198,665 | 3,200 | 1,012 | 5,078 | 343 | 750 | 1,200 | 6,043 | 190 | | | 216,481 |
| Total restricted | 578,259 | 4,331 | 1,043 | 9,754 | 343 | 1,390 | 1,825 | 13,436 | 190 | - | - | 610,571 |
| **Unrestricted** | 436,110 | 3,283 | 8,664 | | 3,712 | | | | | | 50,331 | 502,100 |
| Total net assets | $ 1,736,857 | $ 11,884 | $ 9,707 | $ 9,754 | $ 17,033 | $ 1,390 | $ 1,825 | $ 13,436 | $ 190 | $ 235 | $ 60,845 | $ 1,863,156 |

**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS**
**CONSOLIDATING SCHEDULE FOR THE YEAR ENDED JUNE 30, 2005**
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**
**(in thousands)**

| | UK | UK Research Foundation | The Fund | Gluck Equine Research Foundation | UK Athletic Association | Humanities Foundation | Mining Engineering Foundation | Business Partnership Foundation | Center on Aging | Central Kentucky Management Services | Kentucky Medical Services Foundation | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **OPERATING REVENUES** | | | | | | | | | | | | |
| Student tuition and fees, net | $ 133,389 | | | | | | | | | | | $ 133,389 |
| Federal grants and contracts | 13,262 | $ 126,372 | | | | | | | | | | 139,634 |
| State and local grants and contracts | 28,233 | 59,640 | $ 275 | | | | | | | | | 88,148 |
| Nongovernmental grants and contracts | 4,860 | 23,088 | 2,165 | | | | | | | | | 30,113 |
| Recoveries of facilities and administrative costs | 298 | 40,035 | | | | | | | | | | 40,333 |
| Sales and services | 24,104 | 766 | 10,283 | | | | $ 1 | | $ 3 | $ 3,700 | | 38,857 |
| Federal appropriations | 16,136 | | | | | | | | | | | 16,136 |
| County appropriations | 11,567 | | | | | | | | | | | 11,567 |
| Professional clinical service fees | | | | | | | | | | | $ 152,477 | 152,477 |
| Hospital patient services | 440,609 | | | | | | | | | | | 440,609 |
| Auxiliary enterprises: | | | | | | | | | | | | |
| Housing and Dining, net | 32,142 | | | | | | | | | | | 32,142 |
| Athletics | | | | | $ 42,408 | | | | | | | 42,408 |
| Other auxiliaries | 20,699 | | | | | | | | | | | 20,699 |
| Other operating revenues | 384 | | 23 | | | | | | | | 59 | 466 |
| Total operating revenues | 725,683 | 249,901 | 12,746 | - | 42,408 | - | 1 | - | 3 | 3,700 | 152,536 | 1,186,978 |
| **OPERATING EXPENSES** | | | | | | | | | | | | |
| Educational and general: | | | | | | | | | | | | |
| Instruction | 219,032 | 15,108 | 1,063 | | | | 37 | $ 69 | | | | 235,309 |
| Research | 65,952 | 153,540 | 125 | $ 50 | | | 37 | 69 | 179 | | | 219,952 |
| Public service | 84,077 | 51,983 | 480 | | | | 8 | 2 | | | | 136,550 |
| Libraries | 13,437 | | 4 | | | | | | | | | 13,441 |
| Academic support | 36,912 | 1,603 | 2,247 | | | | | 290 | | | | 41,052 |
| Student services | 18,578 | 35 | 82 | | | $ 10 | | | | | | 18,705 |
| Institutional support | 49,491 | 687 | 134 | | | | | | | 3,682 | | 53,994 |
| Operations and maintenance of plant | 45,577 | | | | | | | | | | | 45,577 |
| Student financial aid | 27,621 | 1,282 | 57 | | | 24 | | 182 | | | | 29,166 |
| Depreciation | 53,164 | 295 | | | | | | | | 69 | | 53,528 |
| Total educational and general | 613,841 | 224,533 | 4,192 | 50 | - | 34 | 82 | 612 | 179 | 3,751 | - | 847,274 |
| Clinical operations (including depreciation of $726) | | | | | | | | | | | 121,015 | 121,015 |
| Hospital (including depreciation of $19,265) | 406,950 | | | | | | | | | | | 406,950 |
| Auxiliary enterprises: | | | | | | | | | | | | |
| Housing and Dining (including depreciation of $2,183) | 34,093 | | | | | | | | | | | 34,093 |
| Athletics (including depreciation of $2,516) | (495) | | | | 44,968 | | | | | | | 44,473 |
| Other auxiliaries | 14,018 | | | | | | | | | | | 14,018 |
| Other expenses | 382 | | | | | | | | | | | 382 |
| Total operating expenses | 1,068,789 | 224,533 | 4,192 | 50 | 44,968 | 34 | 82 | 612 | 179 | 3,751 | 121,015 | 1,468,205 |
| Net income (loss) from operations | (343,106) | 25,368 | 8,554 | (50) | (2,560) | (34) | (81) | (612) | (176) | (51) | 31,521 | (281,227) |
| **NONOPERATING REVENUES (EXPENSES)** | | | | | | | | | | | | |
| State appropriations | 287,897 | | | | | | | | | | | 287,897 |
| Gifts and grants | 23,301 | 18 | 493 | 611 | 2 | 5 | | 106 | 103 | | | 24,639 |
| Investment income | 52,695 | 327 | 184 | 639 | 303 | 93 | 132 | 962 | 5 | 7 | 1,170 | 56,517 |
| Interest on capital asset-related debt | (11,005) | | | | (2,057) | | | | | | | (13,062) |
| Grant to/(from) the University for non-capital purposes | 47,592 | (15,895) | (7,702) | (610) | 7,338 | (12) | (18) | (154) | | | (30,539) | - |
| Other nonoperating revenues and expenses | 1,060 | 761 | | | 1,522 | | | | | | | 3,343 |
| Net nonoperating revenues | 401,540 | (14,789) | (7,025) | 640 | 7,108 | 86 | 114 | 914 | 108 | 7 | (29,369) | 359,334 |
| Net income (loss) before other revenues, expenses, gains, or losse | 58,434 | 10,579 | 1,529 | 590 | 4,548 | 52 | 33 | 302 | (68) | (44) | 2,152 | 78,107 |
| Capital appropriations | 732 | | | | | | | | | | | 732 |
| Capital grants and gifts | 19,208 | 103 | | | | | | | | | (396) | 18,915 |
| Additions to permanent endowments | 33,539 | | | | | | 60 | 51 | | | | 33,650 |
| Grant to/(from) the University for capital purposes | 14,288 | (9,482) | (1,187) | | (3,605) | | | (2) | (12) | | | - |
| Transfer of net assets of Lexington Community College | (4,968) | | | | | | | | | | | (4,968) |
| Other | (1,783) | | | | 26 | | | | | | | (1,757) |
| Total other revenues | 61,016 | (9,379) | (1,187) | - | (3,579) | - | 60 | 49 | (12) | - | (396) | 46,572 |
| **INCREASE (DECREASE) IN NET ASSETS** | 119,450 | 1,200 | 342 | 590 | 969 | 52 | 93 | 351 | (80) | (44) | 1,756 | 124,679 |
| **NET ASSETS, beginning of year** | 1,617,407 | 10,684 | 9,365 | 9,164 | 16,064 | 1,338 | 1,732 | 13,085 | 270 | 279 | 59,089 | 1,738,477 |
| **NET ASSETS, end of year** | $ 1,736,857 | $ 11,884 | $ 9,707 | $ 9,754 | $ 17,033 | $ 1,390 | $ 1,825 | $ 13,436 | $ 190 | $ 235 | $ 60,845 | $ 1,863,156 |

# Governing Board and Administrative Staff as of June 30, 2005

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# University of Kentucky
# Albert B. Chandler Medical Center
# University Hospital
# Consolidated Financial Statements

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# INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of the
University of Kentucky

We have audited the accompanying consolidated statements of net assets of the University of Kentucky Albert B. Chandler Medical Center University Hospital (an organizational and component unit of the University of Kentucky) and subsidiary (the Hospital) as of June 30, 2005 and 2004, and the related consolidated statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated 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 respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The financial statements of the Hospital are intended to present the financial position, and the changes in net assets and cash flows, of only that portion of the activities of the University of Kentucky that are attributable to the transactions of the Hospital. They do not purport to, and do not, present fairly the financial position of the University of Kentucky and affiliated corporations as of June 30, 2005 and 2004, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Hospital and its subsidiary as of June 30, 2005 and 2004, and its changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 2 through 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Hospital's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

September 1, 2005

# Management's Discussion and Analysis

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of the University of Kentucky Albert B. Chandler Medical Center University Hospital (the Hospital) and it's wholly-owned for-profit subsidiary for the years ended June 30, 2005 and 2004. Management has prepared this discussion, and we encourage you to read it in conjunction with the consolidated financial statements and the notes appearing in this report.

**About the University Hospital**

The UK Chandler Medical Center, which opened in 1960, is considered one of the nation's finest academic medical centers. The faculty, students and staff take pride in achieving excellence in education, patient care, research, and community service. As one of two Level 1 Trauma Centers in the state and the first health-care facility in Central and Eastern Kentucky to obtain distinction as a Primary Stroke Center, UK Hospital cares for the most critically injured and ill patients in the region. The 473-bed UK Hospital and Kentucky Children's Hospital are supported by more than 500 faculty physicians and dentists, 400 resident physicians, and a staff of 3,200 health professionals committed to high-quality patient care.

The Hospital's mission is to help the people of the Commonwealth and beyond gain and retain good health through creative leadership and quality initiatives in patient care, education and research. The Hospital serves patients primarily from central and eastern Kentucky and offers a full spectrum of routine and specialty services appropriate for a major regional quaternary care center.

**Financial Highlights**

The Hospital's overall financial position remains strong with assets of $509.3 million and liabilities of $52.7 million. Net assets, which represent the Hospital's residual interest in assets after liabilities are deducted, were $456.7 million or 89.7 percent of total assets. For the fiscal year ended June 30, 2005, the Hospital reported net income before other changes in net assets of $45.7 million generating a margin of 10.3 percent.

- Financial results for fiscal year 2005 significantly exceeded revenue expectations with net inpatient revenue increasing approximately $48.2 million or 19.2 percent over the prior fiscal year and net outpatient revenues increasing $21.8 million or 18.5 percent over the previous fiscal year. The additional revenues are primarily the result of increases in patient activity.
- Total assets increased $35.4 million or 7.5 percent. Significant components of the increase in assets include an increase in cash and cash equivalents of $35.1 million, a net increase of $5.5 million in patient accounts receivable, a decrease in net capital assets of $5.0 million, and $3.1 million decrease in third party payor settlements receivable.
- Total liabilities increased $7.1 million to $52.7 million, primarily due to increases in accounts payable and accrued expenses.
- Total net assets increased $28.3 million or 6.6 percent.
- Operating revenues increased $70.0 million to approximately $441.9 million.
- Operating expenses increased $63.5 million to $404.8 million due primarily to increases in purchased services, salary adjustments and provision for uncollectible accounts.

## Operating Statistics

The following table presents utilization statistics for the Hospital for fiscal years ended 2005, 2004 and 2003:

| **Statistics** | **2005** | **2004** | **2003** |
|---|---|---|---|
| Discharges: | | | |
| Medicare | 5,574 | 4,591 | 4,596 |
| Medicaid | 6,544 | 5,942 | 5,679 |
| Commercial/Blue Cross | 7,933 | 7,095 | 7,057 |
| Patient/charity | 2,218 | 2,036 | 1,766 |
| Total discharges | 22,269 | 19,664 | 19,098 |
| Average daily census | 336 | 308 | 304 |
| Average length of stay | 5.51 | 5.72 | 5.81 |
| Patient Days: | | | |
| Medicare | 32,871 | 27,971 | 26,797 |
| Medicaid | 41,084 | 40,507 | 35,228 |
| Commercial/Blue Cross | 36,099 | 32,170 | 40,136 |
| Patient/charity | 12,650 | 11,927 | 8,739 |
| Total patient days | 122,704 | 112,575 | 110,900 |
| Outpatient visits: | | | |
| Hospital clinics | 266,245 | 246,546 | 207,532 |
| Emergency visits | 42,909 | 40,320 | 38,212 |
| Total visits | 309,154 | 286,866 | 245,744 |

Total discharges increased by 2,605 or 13.2 percent compared to the prior fiscal year. The major factor in this increase was due to improved recruitment and retention of medical faculty and staff combined with an increase in available beds. The change in discharges from 2003 to 2004 was an increase of 566 or 3.0 percent.

Total patient days increased by 10,129 or 9.0 percent. The case mix index increased to 1.7064 from 1.6864 and the average length of stay decreased to 5.51 from 5.72.

Total outpatient visits increased by 22,288 or 7.8 percent over the prior year.

## Using the Consolidated Financial Statements

The Hospital presents its financial reports in a "business type activity" format, in accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. In addition to this MD&A section, the financial report includes a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, a Statement of Cash Flows, and Notes to the Financial Statements. GASB requires that statements be presented on a consolidated basis to focus on the Hospital as a whole.

## Reporting Entity

The University of Kentucky Albert B. Chandler Medical Center University Hospital is a division of the University of Kentucky (the University). The consolidated financial statements include Kentucky Healthcare Enterprise, Inc. (KHE), a wholly-owned for-profit subsidiary (collectively, the Hospital).

The University Hospital provides inpatient, outpatient and emergency care services for residents of the Commonwealth of Kentucky.

## Consolidated Statement of Net Assets

The Consolidated Statement of Net Assets is the Hospital's balance sheet. It reflects the total assets, liabilities and net assets (equity) of the Hospital as of June 30, 2005, with comparative information as of June 30, 2004. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Net assets, the difference between total assets and total liabilities, are an important indicator of the Hospital's current financial condition, while the change in net assets is an indicator of whether the overall financial position has improved or worsened during the year. Generally, assets and liabilities are reported using current values. A major exception is capital assets, which are stated at historical cost, less accumulated depreciation. A summarized comparison of the Hospital's assets, liabilities and net assets at June 30, 2005, 2004 and 2003 is as follows:

***Condensed Consolidated Statement of Net Assets (in thousands)***

| **ASSETS** | **2005** | **2004** | **2003** |
|---|---|---|---|
| Current assets | $ 322,867 | $ 283,907 | $ 278,516 |
| Capital assets, net of depreciation | 133,279 | 138,277 | 120,248 |
| Other noncurrent assets | 53,183 | 51,765 | 55,170 |
| Total assets | 509,329 | 473,949 | 453,934 |
| **LIABILITIES** | | | |
| Current liabilities | 42,165 | 33,743 | 38,626 |
| Noncurrent liabilities | 10,487 | 11,844 | 5,033 |
| Total liabilities | 52,652 | 45,587 | 43,659 |
| **NET ASSETS** | | | |
| Invested in capital assets, net of related debt | 130,986 | 133,078 | 113,909 |
| Restricted expendable | 687 | 569 | 845 |
| Unrestricted | 325,004 | 294,715 | 295,521 |
| Total net assets | $ 456,677 | $ 428,362 | $ 410,275 |

***Assets.*** As of June 30, 2005, the Hospital's total assets amounted to approximately $509.3 million. Cash and cash equivalents represented the Hospital's largest asset, totaling $270.6 million or 53.1 percent of total assets. Capital assets, net of depreciation, totaling $133.3 million or 26.2 percent of total assets, were the Hospital's next largest asset. Accounts receivable, totaling $50.2 million or 9.9 percent of total assets represent another significant asset of the Hospital. The Hospital has an investment in a provider-owned health plan, with a net book value of approximately $30.3 million at June 30, 2005.

Total assets increased by $35.4 million during the year ended June 30, 2005. This increase was driven by:

- An increase in cash (including restricted cash) and cash equivalents of approximately $35.1 million, primarily due to hospital operating revenues in excess of operating expenses.
- An increase in accounts receivable of approximately $5.5 million, due to increased patient activity.
- A decrease in capital assets of approximately $5.0 million.
- A decrease in third party payor settlements receivable of approximately $3.1 million.

***Liabilities.*** At June 30, 2005, the Hospital's liabilities totaled approximately $52.7 million. Accounts payable represent approximately $15.3 million or 29.0 percent of liabilities. Accrued expenses, primarily payroll, vacation and other employee benefits, totaled $18.1 million or 34.4 percent of liabilities.

***Net Assets.*** Net assets at June 30, 2005 totaled approximately $456.7 million, or 89.7 percent of total assets. Net assets invested in capital assets, net of related debt, totaled $131.0 million or 28.7 percent of total net assets. Restricted net assets totaled approximately $687,000 or less than one percent of total net assets. Unrestricted net assets accounted for $325.0 million or 71.2 percent of total net assets. Total net assets increased $28.3 million or 6.6 percent.

Restricted net assets are subject to externally imposed restrictions governing their use. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the unrestricted net assets have been internally designated for support of academic and research programs and initiatives, capital projects, and working capital requirements

**Consolidated Statement of Revenues, Expenses and Changes in Net Assets**

The Consolidated Statement of Revenues, Expenses and Changes in Net Assets is the Hospital's income statement. It details how net assets have increased (or decreased) during the year ended June 30, 2005, with comparative information for the year ended June 30, 2004. This statement is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. All items that increase or decrease net assets must appear on the Consolidated Statement of Revenues, Expenses and Changes in Net Assets as revenues, expenses, gains or losses.

Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations and gifts to be classified as nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. A summarized comparison of the Hospital's revenues, expenses and changes in net assets for the years ended June 30, 2005, 2004 and 2003 is as follows:

***Condensed Consolidated Statement of Revenues, Expenses and Changes in Net Assets (in thousands)***

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| **OPERATING REVENUES** | | | |
| Net patient service revenues | $ 439,027 | $ 369,044 | $ 342,417 |
| Sales and services | 2,908 | 2,938 | 2,725 |
| Total operating revenues | 441,935 | 371,982 | 345,142 |
| **OPERATING EXPENSES** | | | |
| Salaries and wages | 126,685 | 112,151 | 105,127 |
| Fringe benefits | 32,898 | 28,180 | 26,388 |
| Supplies | 85,194 | 79,210 | 69,856 |
| Purchased services | 66,178 | 51,071 | 40,570 |
| Other expenses | 35,208 | 28,819 | 28,584 |
| Provision for uncollectible accounts | 39,380 | 26,753 | 26,188 |
| Provision for depreciation and amortization | 19,234 | 15,139 | 13,923 |
| Total operating expenses | 404,777 | 341,323 | 310,636 |
| **OPERATING INCOME - continuing operations** | 37,158 | 30,659 | 34,506 |
| **NONOPERATING REVENUES (EXPENSES)** | | | |
| State appropriations | 1,053 | 1,053 | 1,053 |
| Gifts | 1,012 | 1,405 | 664 |
| Investment income | 5,674 | 834 | 8,124 |
| Interest expense | (85) | (290) | (594) |
| Gain (loss) on disposal of capital assets | (418) | (22) | 742 |
| Other | - | 8 | (106) |
| Equity in income (loss) of unconsolidated investees | 1,266 | (5,973) | 6,104 |
| Income before other revenues, expenses, gains or losses | 45,660 | 27,674 | 50,493 |
| Transfer to the University of Kentucky-noncapital | (13,347) | (9,684) | (10,721) |
| Transfer (to) from the University of Kentucky-capital | (3,958) | 206 | 5,542 |
| **DISCONTINUED OPERATIONS** | | | |
| Net loss from discontinued operations | (40) | (78) | (217) |
| Loss on disposal of capital assets | - | (31) | (25) |
| Net loss from discontinued operations | (40) | (109) | (242) |
| Total increase in net assets | 28,315 | 18,087 | 45,072 |
| Net assets, beginning of year | 428,362 | 410,275 | 365,203 |
| Net assets, end of year | $ 456,677 | $ 428,362 | $ 410,275 |

**Operating Revenues:**

Total operating revenues were approximately $441.9 million for the year ended June 30, 2005, an increase of approximately $70.0 million or 18.8 percent over 2004. Operating revenues increased $26.8 million or 7.8 percent in fiscal year 2004 over 2003.

The most significant source of operating revenue for the Hospital was net patient service revenue of $439.0 million. Of the $70.0 million increase in operating revenues, essentially all came from net patient revenues, primarily due to increased patient activity in almost all services due to improved recruitment and retention of medical faculty and staff combined with an increase in available beds. In fiscal year 2004, net patient service revenue increased by $26.6 million or 7.8 percent over 2003. Patient service revenues are net of estimated allowances from contractual arrangements with Medicare, Medicaid, and other third-party payors and have been estimated based on the terms of reimbursement and contracts currently in effect.

The following table shows net patient revenue by funding source for fiscal years ended June 30, 2005, 2004 and 2003 (in thousands):

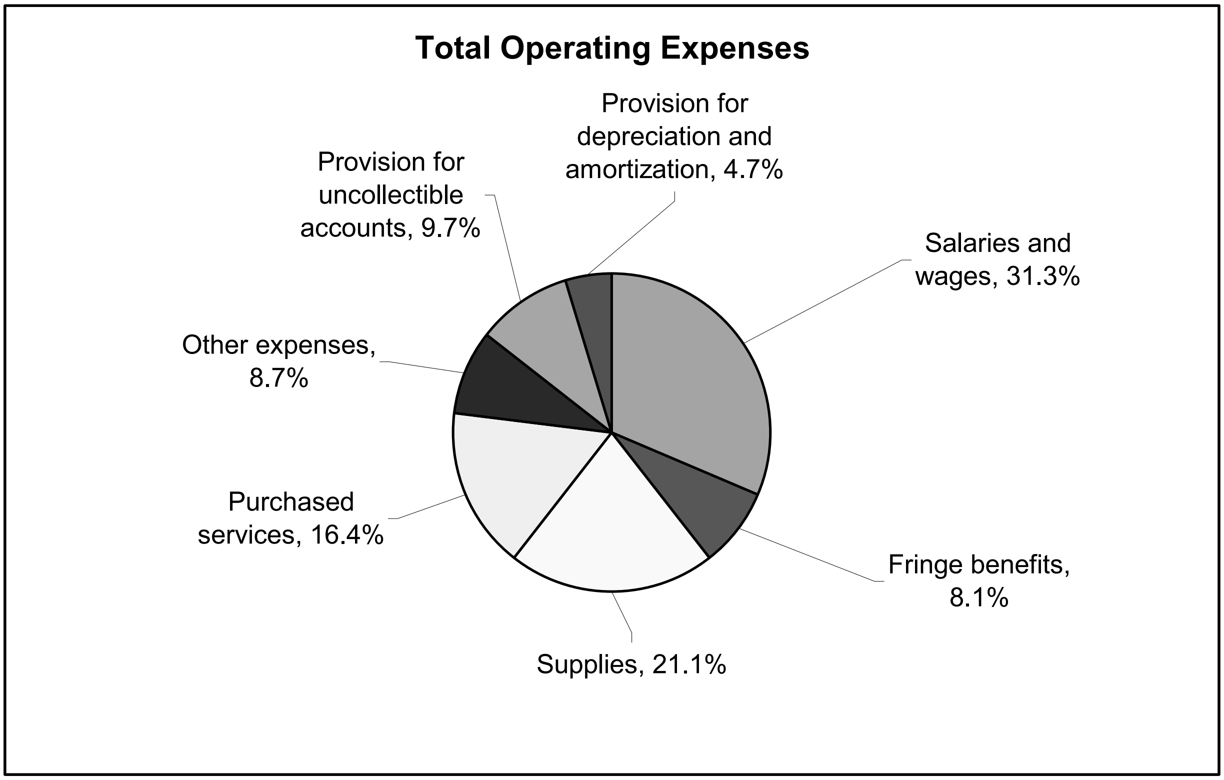
| **Payor** | **2005** | **2004** | **2003** |
|---|---|---|---|
| Medicare | $ 107,903 | $ 90,288 | $ 83,268 |
| Medicaid | 102,020 | 91,739 | 75,435 |
| Commercial/Blue Cross | 186,618 | 152,223 | 154,008 |
| Patient/charity | 42,486 | 34,794 | 29,706 |
| Total | $ 439,027 | $ 369,044 | $ 342,417 |

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Hospital also receives additional payments for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system. Medicare reimburses the Hospital for allowable costs at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. Settlements with the Medicare program for prior years cost reports are recognized in the year the settlement is resolved. Excluding settlement adjustments, net patient revenue for Medicare increased by $20.0 million over the prior fiscal year.

Net revenues for Medicaid represent payments for services provided to Medicaid beneficiaries. Payments for inpatient services are paid on a per discharge basis and include Intensity Operating Allowance revenues, which are intergovernmental transfer payments available for public institutions to assure access for providing care to Medicaid participants. Outpatient services are reimbursed based upon a combination of fee schedule, per case and retrospective cost settlement basis.

Net revenues for patient/charity include reimbursement for uncompensated care by the Commonwealth of Kentucky from Disproportionate Share Hospital funds.

## TOTAL OPERATING EXPENSES




**Operating Expenses:**

Total operating expenses, including $19.2 million of depreciation, were $404.8 million, an increase of $63.5 million or 18.6 percent over the prior year. Total operating expenses for 2004 increased by $30.7 million or 9.9 percent over 2003.

Salaries and employee benefit expenses increased by $19.3 million over the prior fiscal year due to inflationary increases in benefits for health insurance, benefits tax payable to the University, and FICA that amounted to $3 million; adjustments of 3.6 percent for merit raises and market survey adjustments which totaled $3.5 million; and $4.3 million for the change in rate blend of base salaries. In addition, the Hospital added 154.50 FTE's, which added an additional $7.2 million in wages and $1.8 million in benefits, due to the operation of additional beds in the hospital. The Hospital is licensed to operate 473 beds. The number of available beds increased to 436 in 2005 from 406 in 2004. Salary and employee benefit expenses increased by $8.8 million in fiscal year 2004 over 2003.

Purchased services increased $15.1 million or 29.6 percent from fiscal year 2004. The Hospital purchased services from various departments in the College of Medicine, including resident costs, totaling $48.7 million or an increase of $11.5 million from the prior fiscal year. The Hospital also increased its support of security by $1 million and various other agreements through the College of Medicine Dean's Office increased by $1.8 million.

Other expenses rose by $6.4 million or 22.2 percent in fiscal year 2005. Equipment related expenses, such as maintenance and repair, were considerably higher due to the age of the equipment. In addition, new equipment resulted in larger service contracts which totaled approximately $1.0 million. Other factors were increased utilities of $3.0 million and minor renovations that totaled approximately $4.0 million.

Supplies expenses increased by $6.0 million or 7.6 percent mainly due to increases in overall patient activity. Supplies expenses increased in fiscal year 2004 by $9.4 million or 13.4 percent over 2003 due to inflation and volume increases.

**Nonoperating Revenues (Expenses):**

Total nonoperating revenues (expenses) were $8.5 million for fiscal year 2005 compared to $(3.0) million for the prior fiscal year, primarily due to the increase in equity in income of unconsolidated investees and an increase in investment income.

## Consolidated Statement of Cash Flows

The Consolidated Statement of Cash Flows details how cash has increased (or decreased) during the year ended June 30, 2005, with comparative financial information for the year ended June 30, 2004. It breaks out the sources and uses of cash into the following categories:

- Operating activities
- Non-capital financing activities
- Capital financing activities
- Investing activities

Cash flows associated with the Hospital's expendable net assets appear in the operating and non-capital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt, and debt repayments. Purchases and sales of investments are reflected in investing activities.

The primary purpose of the Consolidated Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the Hospital during the year that will allow financial statement readers to assess the Hospital's:

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

A comparative summary of the Hospital's Statement of Cash Flows for the years ended June 30, 2005, 2004 and 2003 is as follows:

***Condensed Consolidated Statement of Cash Flows (in thousands)***

| **Cash provided (used) by:** | **2005** | **2004** | **2003** |
|---|---|---|---|
| Operating activities | $ 60,104 | $ 59,859 | $ 60,277 |
| Noncapital financing activities | (10,909) | (5,992) | (11,426) |
| Capital and related financing activities | (20,312) | (34,844) | (30,106) |
| Investing activities | 6,260 | (4,092) | 8,065 |
| Net increase in cash | 35,143 | 14,931 | 26,810 |
| **Cash and cash equivalents, beginning of year** | 235,411 | 220,480 | 193,670 |
| **Cash and cash equivalents, end of year** | $ 270,554 | $ 235,411 | $ 220,480 |

A major source of cash included in operating activities is patient service revenues of $399.3 million. The largest cash payments for operating activities were $186.4 million to suppliers and $156.7 million to employees for salaries, wages and fringe benefits.

Cash used by noncapital financing activities consists primarily of transfers to University of Kentucky for noncapital purposes.

Cash used by capital and related financing activities is primarily expended on the construction and acquisition of capital assets and principal payments on long-term obligations.

Cash provided by investing activities reflects investment income.

The following table shows key liquidity and capital ratios for fiscal years 2005, 2004 and 2003:

| | **2005** | **2004** | **2003** |
|---|---|---|---|
| Days cash on hand | 251 | 258 | 258 |
| Days of revenue in accounts receivable | 42 | 44 | 64 |
| Debt service coverage (times) | 14.0 | 11.9 | 14.9 |

Days cash on hand decreased to 251 days in fiscal year 2005 from 258 days in fiscal year 2004. Days cash on hand measures the average number of days' expenses the Hospital maintains in cash.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. Fiscal year 2005 days in accounts receivable decreased by 2 days to 42. The main reason for this decrease was increased cash collections resulting from a formal revenue cycle team that focuses on various cash initiatives.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The Hospital's ratio for fiscal year 2005 is 14.0 versus 11.9 in fiscal year 2004.

## Capital Asset and Debt Administration

***Capital Assets***

Capital assets, net of accumulated depreciation, totaled approximately $133.3 million at June 30, 2005, a net decrease of $5.0 million over the prior year end. Significant changes in capital assets during fiscal 2004-2005 included (in millions):

- Land, buildings and structures, net additions $ 3.6
- Equipment and vehicles, net deletions $ (3.3)
- Capitalized software additions $ 1.8
- Construction in process, net additions $ .7
- Increase in accumulated depreciation, net $ (7.8)

***Debt***

At year-end, the Hospital had $1.8 million in hospital revenue bonds outstanding. The 2005 Kentucky General Assembly granted the Hospital authority to issue $100 million in bonds for the initial phase of the construction of a replacement patient care facility.

## Economic Factors Impacting Future Periods

The following are known facts and circumstances that will affect future financial results:

- Net operating revenue for FY 2005-06 is budgeted to increase approximately 11.9 percent or $52.6 million due to a rate increase effective July 1, 2005 and continued incremental patient activity.
- State appropriations are expected to remain constant at $1.1 million.
- The Hospital is largely supported by revenue from patient services. The local, state, and national economies, as well as national and state spending priorities affect moneys available for payment for healthcare services. Potential changes at the State and Federal level in Medicare and Medicaid spending could reduce revenues for the Hospital. Employers are shifting more of the cost of healthcare to employees, which may result in increased charity care and bad debt expense.
- Advances in care from new technology are putting upward pressure on the cost of care. To adjust to these changes, the Hospital must make constant improvements in the cost and efficiency of delivering care and programs must be developed and expanded to create new revenues.
- The University does not record a liability for post-employment retiree health benefits. Governmental Accounting Standards require that this liability be recognized in the financial statements beginning June 30, 2008. The University has not completed its evaluation of the impact that the adoption of this statement will have on its financial statements, but it is likely to be significant. The financial impact would be in part funded by the Hospital.
- The Hospital is planning the replacement of its current facility, which was built in 1960. Currently, the Hospital has received $200 million legislative authority, with $100 million debt authority and $100 million to be funded from internal funds. During the next budget cycle of the Commonwealth, the Hospital expects to obtain the legislative approval needed for the additional funding of the initial phase of the project. The Hospital has engaged an architect to begin the planning of the facility scope, with final construction expected in 2010.

**UNIVERSITY OF KENTUCKY**
**ALBERT B. CHANDLER MEDICAL CENTER**
**UNIVERSITY HOSPITAL**
**CONSOLIDATED STATEMENT OF NET ASSETS (in thousands)**
**JUNE 30, 2005 AND 2004**

| | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 264,634 | $ 230,075 |
| Accounts receivable (less allowance for doubtful accounts of $12,611 and $14,269) | 50,229 | 44,680 |
| Inventories and other | 7,164 | 4,910 |
| Accrued interest receivable | 115 | 465 |
| Estimated third-party payor settlements receivable | - | 3,052 |
| Notes receivable | 725 | 725 |
| Total current assets | 322,867 | 283,907 |
| **Noncurrent Assets** | | |
| Restricted cash and cash equivalents | 5,920 | 5,336 |
| Equity in health care corporations | 31,379 | 30,313 |
| Long-term investments | 9,492 | 9,510 |
| Capital assets, net | 133,279 | 138,277 |
| Other assets | 6,392 | 6,606 |
| Total noncurrent assets | 186,462 | 190,042 |
| Total assets | 509,329 | 473,949 |
| **LIABILITIES** | | |
| **Current Liabilities** | | |
| Accounts payable | 15,266 | 11,548 |
| Accrued expenses | 18,139 | 15,526 |
| Estimated third-party payor settlements payable | 2,399 | - |
| Deferred revenue | 4,446 | 3,393 |
| Long-term debt-current portion | 1,770 | 2,080 |
| Capital lease obligations-current portion | 145 | 1,196 |
| Total current liabilities | 42,165 | 33,743 |
| **Noncurrent Liabilities** | | |
| Accrued expenses | 4,645 | 4,493 |
| Deferred revenue and other | 5,464 | 5,428 |
| Long-term debt | - | 1,770 |
| Capital lease obligations | 378 | 153 |
| Total noncurrent liabilities | 10,487 | 11,844 |
| Total liabilities | 52,652 | 45,587 |
| **NET ASSETS** | | |
| **Invested in capital assets, net of related debt** | 130,986 | 133,078 |
| **Restricted** | | |
| Expendable | | |
| Debt service | 4 | 23 |
| Other | 683 | 546 |
| Total restricted expendable | 687 | 569 |
| Total restricted | 687 | 569 |
| **Unrestricted** | 325,004 | 294,715 |
| Total net assets | $ 456,677 | $ 428,362 |

See notes to consolidated financial statements.

**UNIVERSITY OF KENTUCKY**
**ALBERT B. CHANDLER MEDICAL CENTER**
**UNIVERSITY HOSPITAL**
**CONSOLIDATED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (in thousands)**
**FOR THE YEARS ENDED JUNE 30, 2005 AND 2004**

| | 2005 | 2004 |
|---|---|---|
| **OPERATING REVENUES** | | |
| Net patient service revenues | $ 439,027 | $ 369,044 |
| Sales and services | 2,908 | 2,938 |
| Total operating revenues | 441,935 | 371,982 |
| **OPERATING EXPENSES** | | |
| Salaries and wages | 126,685 | 112,151 |
| Fringe benefits | 32,898 | 28,180 |
| Supplies | 85,194 | 79,210 |
| Purchased services | 66,178 | 51,071 |
| Other expenses | 35,208 | 28,819 |
| Provision for uncollectible accounts | 39,380 | 26,753 |
| Provision for depreciation and amortization | 19,234 | 15,139 |
| Total operating expenses | 404,777 | 341,323 |
| Net income from continuing operations | 37,158 | 30,659 |
| **NONOPERATING REVENUES (EXPENSES)** | | |
| State appropriations | 1,053 | 1,053 |
| Gifts | 1,012 | 1,405 |
| Investment income | 5,674 | 834 |
| Interest expense | (85) | (290) |
| Gain (loss) on disposal of capital assets | (418) | (22) |
| Other | - | 8 |
| Equity in income (loss) of unconsolidated investees | 1,266 | (5,973) |
| Net nonoperating revenues ( expenses) | 8,502 | (2,985) |
| Net income before other revenues, expenses, gains or losses | 45,660 | 27,674 |
| Transfers (to) from the University of Kentucky for noncapital purposes | (13,347) | (9,684) |
| Transfers (to) from the University of Kentucky for capital purposes | (3,958) | 206 |
| Total other revenues (expenses) | (17,305) | (9,478) |
| Loss from discontinued operations (includes $71 and $280 revenue from discontinued operations for 2005 and 2004, respectively) | (40) | (78) |
| Loss on disposal of capital assets - discontinued operations | - | (31) |
| Total loss from discontinued operations | (40) | (109) |
| **INCREASE IN NET ASSETS** | 28,315 | 18,087 |
| **NET ASSETS, beginning of year** | 428,362 | 410,275 |
| **NET ASSETS, end of year** | $ 456,677 | $ 428,362 |

See notes to consolidated financial statements.

**UNIVERSITY OF KENTUCKY**
**ALBERT B. CHANDLER MEDICAL CENTER**
**UNIVERSITY HOSPITAL**
**CONSOLIDATED STATEMENT OF CASH FLOWS (in thousands)**
**FOR THE YEARS ENDED JUNE 30, 2005 AND 2004**

| | 2005 | 2004 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net patient service revenues | $ 399,313 | $ 347,837 |
| Sales and services | 4,056 | 7,432 |
| Payments to vendors and contractors | (186,368) | (161,944) |
| Salaries, wages and fringe benefits | (156,677) | (133,322) |
| Other receipts (payments) | (220) | (144) |
| Net cash provided (used) by operating activities | 60,104 | 59,859 |
| **CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES** | | |
| State appropriations | 1,053 | 1,053 |
| Gifts | 1,012 | 1,405 |
| Loan to University of Kentucky departmental units | (352) | - |
| Other nonoperating receipts (payments) | - | 9 |
| Payments on loans to University of Kentucky departmental units | 725 | 1,225 |
| Transfers to (from) the University of Kentucky for noncapital purposes | (13,347) | (9,684) |
| Net cash provided (used) by noncapital financing activities | (10,909) | (5,992) |
| **CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | |
| Proceeds from sale of capital assets | 222 | 511 |
| Purchases of capital assets | (12,894) | (32,116) |
| Principal payments-capital leases and long-term obligations | (3,311) | (2,517) |
| Interest payments-capital leases and long-term obligations | (97) | (264) |
| Transfers (to) from the University of Kentucky for capital purposes | (4,232) | (458) |
| Net cash provided (used) by capital and related financing activities | (20,312) | (34,844) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Proceeds from sales and maturities of investments | 37 | - |
| Investment income | 6,023 | 5,120 |
| Purchase of investments | - | (9,612) |
| Distributed earnings-investments | 200 | 400 |
| Net cash provided (used) by investing activities | 6,260 | (4,092) |
| **NET INCREASE IN CASH** | 35,143 | 14,931 |
| **CASH AND CASH EQUIVALENTS, beginning of year** | 235,411 | 220,480 |
| **CASH AND CASH EQUIVALENTS, end of year** | $ 270,554 | $ 235,411 |
| **Reconciliation of net income from continuing operations to net cash provided (used) by operating activities:** | | |
| Operating income - continuing operations | $ 37,158 | $ 30,659 |
| Loss from discontinued operations | (40) | (78) |
| Adjustments to reconcile net income from continuing operations to net cash provided (used) by operating activities: | | |
| Depreciation and amortization | 19,276 | 15,192 |
| Write off of principal- note receivable | 44 | 13 |
| Uncollectible accounts | 39,380 | 26,753 |
| Change in assets and liabilities: | | |
| Accounts receivable | (44,928) | (11,320) |
| Supplies | (2,254) | (1,578) |
| Estimated third-party payor settlements receivable | 3,052 | (3,052) |
| Other assets | (221) | (144) |
| Accounts payable and accrued expenses | 5,150 | 4,588 |
| Estimated third-party payor settlements payable | 2,399 | (5,724) |
| Deferred revenue and other | 1,088 | 4,550 |
| **Net cash provided (used) by operating activities** | $ 60,104 | $ 59,859 |

See notes to consolidated financial statements.

**UNIVERSITY OF KENTUCKY**
**ALBERT B. CHANDLER MEDICAL CENTER**
**UNIVERSITY HOSPITAL**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Reporting Entity

The University of Kentucky Albert B. Chandler Medical Center University Hospital is a division of the University of Kentucky (the University). The consolidated financial statements include Kentucky Healthcare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary (collectively, the Hospital). All significant balances and transactions between University Hospital and its subsidiary have been eliminated.

The University Hospital provides inpatient, outpatient and emergency care services for residents of the Commonwealth of Kentucky. KHE currently provides psychiatric management services to hospitals in Kentucky.

### Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net assets categories:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:

  *Nonexpendable* – Net assets subject to externally imposed stipulations that they be maintained permanently by the Hospital.

  *Expendable* – Net assets whose use by the Hospital is subject to externally imposed stipulations that can be fulfilled by actions of the Hospital pursuant to those stipulations or that expire by the passage of time.

- Unrestricted: Net assets whose use by the Hospital is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the Hospital's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

### Summary of Significant Accounting Policies

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

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

Noncurrent cash and cash equivalents include the Hospital's plant funds allocated for capital projects, with the exception of unrestricted renewal and replacement cash, which is included in current cash and cash equivalents.

Inventories. Inventories are stated principally at the lower of cost or market.

Capital Assets. Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift. Equipment with a unit cost of $2,000 or more ($1,000 for computers) and having an estimated useful life of greater than one year is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred. Interest costs incurred during construction are capitalized.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings, 10 – 25 years for land and building improvements and infrastructure and 5 – 20 years for equipment.

Title to all capital assets of the Hospital belongs to the University and is subject to liens as agreed to by the University. The financial information relating to capital assets represents assets that the Hospital occupies and uses. Transfer of capital assets to/from the University represents changes in control of individual assets within divisions of the University from one period to another.

Deferred Revenue. Deferred revenue consists of amounts received from the federal government through the Commonwealth of Kentucky for Disproportionate Share Hospital (DSH) funds and other unearned amounts. The DSH amounts are recognized as revenue over the term of the federal government fiscal year, October 1 – September 30.

Net Patient Service Revenues. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including contractual allowances and estimated retroactive adjustments under reimbursement programs with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

The Hospital provides services for patients under third-party reimbursement programs, principally Medicare and Medicaid. These payors generally reimburse the Hospital at amounts different from the Hospital's established rates. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits by the fiscal intermediary.

Revenue from the Medicare and Medicaid programs accounted for approximately 25 percent and 23 percent, respectively, of the Hospital's net patient service revenues for the year ended June 30, 2005 and approximately 24 percent and 25 percent, respectively for the year ended June 30, 2004. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Charity Care. The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Since the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Income Taxes. The University, of which the Hospital is an organizational unit, is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.100 through 164.280. Accordingly, the University is excluded from Federal Income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986.

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

Operating Activities. The Hospital defines operating activities, as reported on the Consolidated Statement of Revenues, Expenses and Changes in Net Assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for goods and services received. Nearly all of the Hospital's revenues and expenses are from exchange transactions. Certain revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as non-operating revenues, in accordance with GASB Statement No. 35.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The accompanying financial statements include estimates for items such as contractual allowances, allowances for doubtful accounts, estimated third-party payor settlements and estimated medical claims payable.

Transactions with the University of Kentucky. Because of the nature of the relationship of the Hospital with the University, the Hospital has substantial transactions with the University, including purchases of various supplies and services. Additionally, the University and its affiliates provide certain administrative support functions to the Hospital. During 2005 and 2004, the Hospital paid approximately $9.1 million and $6.0 million, respectively, to the University as reimbursement for various educational and support functions.

Reclassifications. Certain reclassifications to fiscal 2004 comparative amounts have been made to conform to the fiscal 2005 classifications.

## 2. DEPOSITS AND INVESTMENTS

The fair value and cost of deposits and investments, by type, at June 30, 2005 and 2004 are as follows:

| | 2005 | |
|---|---|---|
| | Fair Value | Cost |
| Cash on deposit with the Commonwealth of Kentucky | $ 270,554 | $ 270,554 |
| United States government securities | 9,492 | 9,677 |
| Equity in health care corporations | 31,379 | 38,180 |
| Total | $ 311,425 | $ 318,411 |

| | 2004 | |
|---|---|---|
| | Fair Value | Cost |
| Cash on deposit with the Commonwealth of Kentucky | $ 235,411 | $ 235,411 |
| United States government securities | 9,510 | 9,677 |
| Equity in health care corporations | 30,313 | 38,180 |
| Total | $ 275,234 | $ 283,268 |

| | 2005 | 2004 |
|---|---|---|
| Statement of Net Assets classification | | |
| Cash and cash equivalents | $ 264,634 | $ 230,075 |
| Restricted cash and cash equivalents | 5,920 | 5,336 |
| Long-term investments | 9,492 | 9,510 |
| Equity in health care corporations | 31,379 | 30,313 |
| Total | $ 311,425 | $ 275,234 |

Included above in the caption "Equity in health care corporations" is the Hospital's approximately 84 percent ownership of CHA Service Company (CHA), a Kentucky for-profit corporation established to provide an integrated health care delivery system throughout the Commonwealth of Kentucky. The Hospital accounts for its investment in CHA by the equity method since, under the provision of CHA's by-laws, the Hospital cannot exercise control over the day-to-day operations of CHA. The Hospital's equity in the net income of CHA for the six months ended June 30, 2005 was approximately $3.8 million (unaudited). This income is not reflected in the Hospital's consolidated financial statements as of June 30, 2005.

The Hospital also owns a 33 percent interest in Bluegrass Stone Therapy Center, Inc. (Bluegrass Stone), a tax-exempt organization, organized in 1987 as a non-stock corporation to provide outpatient lithotripsy services.

A summary of the Hospital's investment in CHA and Bluegrass Stone is as follows (in thousands):

| | 2005 | | |
|---|---|---|---|
| | CHA | Bluegrass Stone | Total |
| Balance, June 30, 2004 | $ 29,069 | $ 1,244 | $ 30,313 |
| Equity in net income | 1,226 | 40 | 1,266 |
| Distributed earnings | - | (200) | (200) |
| Balance, June 30, 2005 | $ 30,295 | $ 1,084 | $ 31,379 |

| | 2004 | | |
|---|---|---|---|
| | CHA | Bluegrass Stone | Total |
| Balance, June 30, 2003 | $ 35,245 | $ 1,441 | $ 36,686 |
| Equity in net income | (6,176) | 203 | (5,973) |
| Distributed earnings | | (400) | (400) |
| Balance, June 30, 2004 | $ 29,069 | $ 1,244 | $ 30,313 |

Summarized financial information of CHA as of, and for, the years ended December 31, 2004 and 2003 is as follows:

| | 2004 | 2003 |
|---|---|---|
| Balance Sheet: | | |
| Total assets | $ 90,603 | $ 94,282 |
| Total liabilities | $ 54,364 | $ 59,508 |
| Stockholders' Equity | $ 36,239 | $ 34,774 |
| Statement of Income: | | |
| Revenues | $ 343,760 | $ 321,102 |
| Expenses | (342,142) | (327,788) |
| Net income (loss) | $ 1,618 | $ (6,686) |

**Deposit and investment policies.** The University's Board of Trustees is responsible for establishing deposit and investment policies for the Hospital. Once established, the Board has delegated day-to-day management to the Treasurer of the University. Deposit and investment policies are developed to insure compliance with state laws and regulations as well as to establish and maintain sound financial management practices.

The Hospital follows Kentucky Revised Statutes (KRS 42.500) for the investment of public funds, which list allowable investment instruments to include: obligations of the United States or a United States government agency; obligations of any corporation of the United States Government; collateralized certificates of deposit; highly rated uncollateralized certificates of deposit, bankers acceptances and commercial paper; highly rated securities issued by a state or local government; and mutual funds comprised of any of the above allowable investments.

For purposes of investment management, the Hospital's deposits and investments can be grouped into three significant categories, as follows:

- Cash on deposit with the University of Kentucky, which the University invests in deposits and repurchase agreements with local banks and the Commonwealth of Kentucky;
- Bond revenue fund investments held by the Treasurer of the Commonwealth of Kentucky as required by the Hospital's bond trust indenture, and invested in pooled fixed income funds managed by the Commonwealth of Kentucky; and
- Short term investments managed by the University, including individual securities purchased and held by the University and short term investments in pooled fixed income funds managed by the Commonwealth of Kentucky.

Cash on deposit with the University and short term investments managed by the University follow the University's Statement of Investment Objectives and Policies for Short-Term Current Funds Investments established by the Investment Committee of the University's Board of Trustees.

The Hospital's policy for the investment of bond revenue funds is governed by the Hospital's bond trust indenture.

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

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

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

- Cash on deposit with the Commonwealth of Kentucky is governed by policy that minimized credit risk in several ways. Deposits are governed by State law which requires full collateralization. Credit risk on repurchase agreements with local banks is mitigated by the issuing financial institution's pledge of specific U.S. treasury or agency securities, held in the name of the University by the Federal Reserve Bank. Credit risk on repurchase agreements with the Commonwealth of Kentucky is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth.
- Bond revenue fund investments held in the Commonwealth's investment pools can invest in U.S. treasuries and agencies; commercial paper or asset backed securities rated in the highest category by a nationally recognized rating agency; certificates of deposit, bankers acceptances, state or local government securities and corporate, Yankee and Eurodollar securities rated in one of the three highest categories by a nationally recognized rating agency; shares of mutual funds (up to 10%); and state and local property tax certificates of delinquency secured by interests in real estate.
- Short-term investments managed by the University are limited to direct obligations of the U.S. Treasury, other appropriate securities issued by federal agencies, repurchase agreements of U.S. government obligations, and certificates of deposit collateralized by U.S. government obligations or general obligations of the University of Kentucky. Short term investments held in the Commonwealth's investment pools are subject to the same credit quality requirements as denoted above for bond revenue fund investments.

***Custodial Credit Risk.*** Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in possession of an outside party.

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

- Cash on deposit with the Commonwealth of Kentucky is invested in deposits and repurchase agreements with local banks, which are held in the University's name, and deposits and repurchase agreements with the Commonwealth of Kentucky, which are held in the Commonwealth's name.
- Bond revenue fund investments and short term investments held in the Commonwealth's investment pools are held in the Commonwealth's name by the Commonwealth's custodian.
- Short term investments managed by the University are held in the University's name by the University's custodian.

***Concentrations of Credit Risk.*** Hospital investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer.

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

- Cash on deposit with the University is not limited as to the maximum amount that may be invested in one issuer. However, all such investments in excess of Federal Depository Insurance are required to be fully collateralized by U.S. treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- Bond revenue fund investments and short-term investments held in the Commonwealth's investment pools are limited as follows: U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers shall not exceed twenty-five (25) per cent of an individual pool and $25,000,000 per issuer, inclusive of commercial paper, bankers' acceptances and certificates of deposit; and U. S. dollar denominated sovereign debt shall not exceed five (5) per cent of any individual portfolio and $25,000,000 per issuer.
- There is no specific limit on the maximum amount of short term investments managed by the University that may be invested in one issuer. However, such investments are limited to direct U.S. government obligations (U.S. Treasuries) and U.S. government agencies.

At June 30, 2005, the Hospital has no investments in any one issuer that represent 5 percent or more of total investments.

***Interest Rate Risk.*** Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Cash on deposit with the Commonwealth of Kentucky has limited exposure to interest rate risk due to the short term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Bond revenue fund investments and short-term investments held in the Commonwealth's short term investment pool are limited to a duration that does not exceed 90 days. Such investments in the Commonwealth's intermediate-term investment pool must maintain a modified duration of less than 3 years.
- Short term investments managed by the University are limited to a maximum maturity of 24 months.

***Foreign Currency Risk.*** Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The Hospital has no exposure to foreign currency risk.

## 3. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net as of June 30, 2005 and 2004 are as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Medicare, Medicaid, and other | $ 49,532 | $ 43,536 |
| Private pay and other Receivables | 697 | 1,144 |
| Total accounts receivable, net | $ 50,229 | $ 44,680 |

## 4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2005 and capital asset activity for the year ended June 30, 2005 are summarized as follows (in thousands):

| | Beginning Balance | Additions | Deletions | Ending Balance |
|---|---|---|---|---|
| Land | $ 3,162 | $ 811 | | $ 3,973 |
| Non-depreciable land improvements | 7 | - | | 7 |
| Depreciable land improvements | 3,149 | - | | 3,149 |
| Buildings | 150,048 | 2,215 | $ 11 | 152,252 |
| Fixed equipment | 4,322 | 569 | - | 4,891 |
| Leasehold improvements | 536 | - | - | 536 |
| Equipment | 118,613 | 8,552 | 11,846 | 115,319 |
| Vehicles | 174 | - | - | 174 |
| Capitalized software | 10,551 | 1,814 | - | 12,365 |
| Construction in process | 872 | 2,354 | 1,685 | 1,541 |
| | 291,434 | 16,315 | 13,542 | 294,207 |
| Accumulated Depreciation: | | | | |
| Depreciable land improvements | 2,871 | (220) | - | 2,651 |
| Buildings | 78,337 | 5,083 | 11 | 83,409 |
| Fixed equipment | 1,918 | 315 | - | 2,233 |
| Leasehold improvements | 216 | 42 | - | 258 |
| Equipment | 69,785 | 12,115 | 11,707 | 70,193 |
| Vehicles | 30 | 44 | - | 74 |
| Capitalized software | - | 2,110 | - | 2,110 |
| | 153,157 | 19,489 | 11,718 | 160,928 |
| Capital assets, net | $ 138,277 | $ (3,174) | $ 1,824 | $ 133,279 |

Capital assets as of June 30, 2004 and capital asset activity for the year ended June 30, 2004 are summarized as follows (in thousands):

| | Beginning Balance | Additions | Deletions | Ending Balance |
|---|---|---|---|---|
| Land | $ 3,162 | | | $ 3,162 |
| Non-depreciable land improvements | 7 | | | 7 |
| Depreciable land improvements | 3,149 | | | 3,149 |
| Buildings | 126,035 | $ 24,243 | $ 230 | 150,048 |
| Fixed equipment | 3,024 | 1,298 | - | 4,322 |
| Leasehold improvements | 736 | - | 200 | 536 |
| Equipment | 101,202 | 25,621 | 8,210 | 118,613 |
| Vehicles | 154 | 150 | 130 | 174 |
| Capitalized software | 8,573 | 1,978 | - | 10,551 |
| Construction in process | 20,879 | 4,698 | 24,705 | 872 |
| | 266,921 | 57,988 | 33,475 | 291,434 |
| Accumulated Depreciation: | | | | |
| Depreciable land improvements | 2,620 | 251 | - | 2,871 |
| Buildings | 73,608 | 4,818 | 89 | 78,337 |
| Fixed equipment | 1,686 | 232 | - | 1,918 |
| Leasehold improvements | 331 | 54 | 169 | 216 |
| Equipment | 68,274 | 9,836 | 8,325 | 69,785 |
| Vehicles | 153 | 7 | 130 | 30 |
| | 146,672 | 15,198 | 8,713 | 153,157 |
| Capital assets, net | $ 120,249 | $ 42,790 | $ 24,762 | $ 138,277 |

## 5. OTHER ASSETS

Other assets at June 30, 2005 and 2004, respectively, are as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Noncurrent portion of non-interest bearing, unsecured receivable from UK Parking and Transportation Services, payable $250,000 annually through 2013 | $ 2,250 | $ 2,500 |
| Noncurrent portion of non-interest bearing, unsecured receivable from UK Office of Associate Vice President-Research, payable $500,000 annually, 2007 through 2010 | 2,000 | 2,000 |
| Noncurrent portion of non-interest bearing, unsecured receivable from UK Office of Associate Vice President-Research, payable $475,000 annually, through 2009 | 1,425 | 1,900 |
| Noncurrent portion of non-interest bearing, unsecured receivable from the College of Pharmacy | 353 | |
| Notes receivable | 360 | 183 |
| Other | 4 | 23 |
| Total other assets | $ 6,392 | $ 6,606 |

## 6. LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2005 and 2004 are summarized as follows (in thousands):

| | 2005 | | | | | |
|---|---|---|---|---|---|---|
| | Beginning Balance | Additions | Reductions | Ending Balance | Current Portion | Noncurrent Portion |
| Hospital Revenue Bonds | $ 3,850 | - | $ 2,080 | $ 1,770 | $ 1,770 | - |

| | 2004 | | | | | |
|---|---|---|---|---|---|---|
| | Beginning Balance | Additions | Reductions | Ending Balance | Current Portion | Noncurrent Portion |
| Hospital Revenue Bonds | $ 3,850 | - | - | $ 3,850 | $ 2,080 | $ 1,770 |

Principal maturities and interest on bonds as of June 30, 2005 are as follows (in thousands):

| | Principal | Interest | Total |
|---|---|---|---|
| 2006 | $ 1,770 | $ 18 | $ 1,788 |

## 7. CAPITAL LEASE OBLIGATIONS

Capital lease obligations as of June 30, 2005 and 2004 are summarized as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Capital lease obligations, at varying rates of imputed interest of 3.48% to 18.82% collateralized by leased equipment with an amortized cost of $3,970,360 and $4,939,900 at June 30, 2005 and 2004 | $ 523 | $ 1,349 |
| Less current portion | (145) | (1,196) |
| Capital lease obligations - long term portion | $ 378 | $ 153 |

Scheduled payments of capital lease obligations are as follows:

| Year ending June 30 | |
|---|---|
| 2006 | $ 172 |
| 2007 | 161 |
| 2008 | 119 |
| 2009 | 90 |
| 2010 | 38 |
| Total | 580 |
| Less amount representing interest | (57) |
| Present value of net minimum lease payments | $ 523 |

## 8. PROGRAM FOR INDIGENT CARE AND CHARITY CARE

The Hospital is reimbursed for uncompensated care, including indigent care, by the Commonwealth of Kentucky based upon available Disproportionate Share Hospital funds. The amounts are included in net patient service revenues and summarized below (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Revenue from the Commonwealth | $ 20,269 | $ 18,259 |
| 2.5% tax paid by Hospital on patient cash receipts | (9,003) | (7,586) |
| Matching contribution paid by Hospital | (6,141) | (5,473) |
| Net amount received, included in net patient service revenues | $ 5,125 | $ 5,200 |

The amount of charges forgone for services and supplies furnished under the Hospital's charity care policy aggregated to approximately $38,528,000 and $27,209,000 in 2005 and 2004, respectively.

## 9. DESIGNATIONS OF UNRESTRICTED NET ASSETS

Unrestricted net assets are designated for specific purposes by action of the University's Board of Trustees or management or may otherwise be limited by contractual obligations. Commitments for the use of unrestricted net assets at June 30, 2005 and 2004 are as follows (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Working capital needs | $ 125,541 | $ 93,213 |
| Future capital expenditures | 199,463 | 201,502 |
| Total | $ 325,004 | $ 294,715 |

## 10. PLEDGED REVENUES

Operating revenues totaling approximately $441,935,000 and $371,982,000, as reflected in the Consolidated Statement of Revenues, Expenses and Changes in Net Assets as of June 30, 2005 and 2004, respectively, are pledged as collateral for the Hospital's Revenue Bonds.

## 11. PENSION PLANS

Regular full-time employees of the Hospital are participants in the University of Kentucky Retirement Plan, a defined contribution plan. Hospital employees participate in one of the following three groups of the University of Kentucky Retirement Plan:

| | |
|---|---|
| Group I | Established July 1, 1964, for faculty and certain administrative officials. |
| Group II | Established July 1, 1971, for staff members in the clerical, technical and service categories. |
| Group III | Established July 1, 1972, for staff members in the managerial, professional and scientific categories. |

Participation in these groups of the University of Kentucky Retirement Plan is mandatory for all regular full-time employees age 30 and older. Participation is voluntary until age 30. The Hospital contributes 10% and each employee contributes 5% of eligible compensation.

The University has authorized three retirement plan carriers, as follows:

Teachers Insurance and Annuity Association/College
Retirement Equities Fund (TIAA/CREF)
Fidelity Institutional Services Company
American Century Investments

In addition to retirement benefits provided from the group retirement plan, the Hospital provides supplemental retirement income benefits to certain eligible employees of the Hospital.

The total contributions charged to operations for the various retirement plans were approximately $8,991,000 and $7,817,000 for the years ended June 30, 2005 and 2004, respectively. Employees contributed $4,495,500 and $3,908,500 during 2005 and 2004, respectively. The payroll for employees covered by the retirement plans was $89,910,000 and $78,165,000 for 2005 and 2004, respectively.

**12. HEALTH INSURANCE BENEFITS FOR RETIREES**

The University of Kentucky provides a health care credit towards health insurance to retirees of the Hospital who have a minimum of fifteen years service. The University recognizes the cost of providing this credit by expensing the credit in the year paid.

**13. RISK MANAGEMENT**

The University, of which the Hospital is an organizational unit, is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims or, (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance, participation in insurance risk retention groups or self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and other causes of loss between $500 and $500,000 per occurrence. Losses in excess of $500,000 are insured by commercial carriers up to $500 million per occurrence principally on an actual cash value basis. As a state agency, the University is vested with Sovereign Immunity and is subject to the provisions of the Board of Claims Act, under which the University's liability for certain negligence claims is limited to $200,000 for any one person and $350,000 for all persons damaged by a single act of negligence. Claims against educators' errors and omissions and wrongful acts are insured through a reciprocal risk retention group. There have been no significant reductions in insurance coverage from 2004 to 2005. Settlements have not exceeded insurance coverage during the past three years.

The University and its agents are insured against medical malpractice by a combination of Sovereign Immunity, self-insurance, commercial liability insurance, and an excess coverage fund established by the Commonwealth of Kentucky. The malpractice liability at June 30, 2005 and 2004 is based on the requirements of GASB No. 10, which requires that a liability for claims be recorded if it is probable that a liability has occurred and the amount of loss can be reasonably estimated. The liability includes an estimate for claims that have been incurred but not reported at June 30, 2005 and 2004. The Hospital funds its share of the medical malpractice liability with the University, and accordingly, has not recognized a liability in these consolidated financial statements.

The University is self-insured for a long-term disability income program and has established a 501(c)(9) trust for purposes of paying claims and establishing necessary reserves.

The University also self-insures certain employee benefits, including worker's compensation, unemployment claims, and a long-term disability supplemental reserve, to the extent not covered by insurance. The University assesses the Hospital a miscellaneous benefit tax on actual payroll dollars based upon an annual calculated rate to fund these benefits.

## 15. FUNCTIONAL INCOME/EXPENSES

Below is a summary of functional income/expenses for the year ended June 30, 2005 (in thousands):

| | Hospital Operations | Nonhospital Operations | Total |
|---|---|---|---|
| Operating revenues: | | | |
| Health care services | $ 439,027 | | $ 439,027 |
| Other revenues | 2,908 | | 2,908 |
| Total operating revenues | 441,935 | | 441,935 |
| Operating expenses: | | | |
| Health care services | 373,748 | | 373,748 |
| General and administrative | 31,029 | | 31,029 |
| Total operating expenses | 404,777 | | 404,777 |
| Income from continuing operations | 37,158 | | 37,158 |
| Nonoperating revenues (expenses): | | | |
| State appropriations | 1,053 | | 1,053 |
| Gifts | 1,012 | | 1,012 |
| Investment income | 5,674 | | 5,674 |
| Interest expense | (85) | | (85) |
| Loss on disposal of capital assets | (418) | | (418) |
| Equity in income (loss) of unconsolidated investees | - | $ 1,266 | 1,266 |
| Net nonoperating revenues | 7,236 | 1,266 | 8,502 |
| Income before other revenues, expenses, gains or losses | 44,394 | 1,266 | 45,660 |
| Transfer to UK-noncapital | (13,347) | - | (13,347) |
| Transfer to UK-capital | (3,958) | - | (3,958) |
| Health care services revenue-discontinued operations | - | 71 | 71 |
| General and administrative expenses-discontinued operations | - | (111) | (111) |
| Net loss from discontinued operations | - | (40) | (40) |
| Increase in net assets | $ 27,089 | $ 1,226 | $ 28,315 |

Nonhospital operations include the accounts of KHE and the Hospital’s interests in CHA and Bluegrass Stone.

Below is a summary of functional income/expenses for the year ended June 30, 2004 (in thousands):

| | Hospital Operations | Nonhospital Operations | Total |
|---|---|---|---|
| Operating revenues: | | | |
| Health care services | $ 369,044 | | $ 369,044 |
| Other revenues | 2,938 | | 2,938 |
| Total operating revenues | 371,982 | | 371,982 |
| Operating expenses: | | | |
| Health care services | 313,841 | | 313,841 |
| General and administrative | 27,482 | | 27,482 |
| Total operating expenses | 341,323 | | 341,323 |
| Income from continuing operations | 30,659 | | 30,659 |
| Nonoperating revenues (expenses): | | | |
| State appropriations | 1,053 | | 1,053 |
| Gifts | 1,405 | | 1,405 |
| Investment income | 834 | | 834 |
| Interest expense | (290) | | (290) |
| Loss on disposal of capital assets | (22) | | (22) |
| Other | 8 | | 8 |
| Equity in income (loss) of unconsolidated investees | - | $ (5,973) | (5,973) |
| Net nonoperating revenues | 2,988 | (5,973) | (2,985) |
| Income before other revenues, expenses, gains or losses | 33,647 | (5,973) | 27,674 |
| Transfer to UK-noncapital | (9,684) | - | (9,684) |
| Transfer to UK-capital | 206 | - | 206 |
| Health care services revenue-discontinued operations | - | 280 | 280 |
| General and administrative expenses-discontinued operations | - | (389) | (389) |
| Net loss from discontinued operations | - | (109) | (109) |
| Increase in net assets | $ 24,169 | $ (6,082) | $ 18,087 |

Nonhospital operations include the accounts of KHE and the Hospital's interests in CHA and Bluegrass Stone.

**EXHIBIT C**

**INFORMATION PERTAINING TO THE COMMONWEALTH OF KENTUCKY**

**Financial Information Regarding the Commonwealth**

The Commonwealth annually publishes The Kentucky Comprehensive Annual Financial Report with respect to the Fiscal Year of the Commonwealth most recently ended. The Kentucky Comprehensive Annual Financial Report includes certain financial statements of the Commonwealth as well as general financial information pertaining to the Accounting System and Budgetary Controls, Debt Administration, Cash Management, Risk Management, General Fund Budgetary Basis and Governmental Funds GAAP Basis. In addition, the Notes to Financial Statements as set forth in The Kentucky Comprehensive Annual Financial Report contain information regarding the basis of preparation of the Commonwealth's financial statements, Funds and Pension Plans. The "Statistical Section" of The Kentucky Comprehensive Annual Financial Report includes information on Commonwealth revenue sources, Commonwealth expenditures by function, taxes and tax sources, taxable property, assessed and estimated values, property tax, levies and collections, demographic statistics (population, per capita income and unemployment rate), construction and bank deposits, sources of personal income and largest Commonwealth manufacturers.

**Certain Financial Information Incorporated by Reference; Availability from NRMSIRs and the Commonwealth**

*The Kentucky Comprehensive Annual Financial Report for Fiscal Year 2004* is incorporated herein by reference. The Commonwealth has filed The Kentucky Comprehensive Annual Financial Report for Fiscal Year 2004 with the following Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") in accordance with SEC Rule 15c2-12:

(i) Bloomberg Municipal Repositories
100 Business Park Drive
Skillman, New Jersey 08558
Internet: munis@bloomberg.com
Tel: (609) 279-3225
Fax: (609) 279-5962

(ii) DPC Data Inc.
One Executive Drive
Fort Lee, New Jersey 07024
Internet: nrmsir@dpcdata.com
Tel: (201) 346-0701
Fax: (201) 947-0107

(iii) Standard & Poor's Securities Evaluations, Inc.
55 Water Street, 45th Floor
New York, New York 10041
Internet: nrmsir_repository@sandp.com
Tel: (212) 770-4595
Fax: (212) 770-7994

(iv) FT Interactive Data
Attn: NRMSIR
100 Williams Street
New York, New York 10038
Internet: nrmsir@ftid.com
Tel: (212) 771-6899
Fax: (212) 771-7390 (Secondary Market Information)
(212) 771-7391 (Primary Market Information)
Website: http://www.InteractiveData.com

A copy of *The Kentucky Comprehensive Annual Financial Report for Fiscal Year 2004* may be obtained from the NRMSIRs or from the Office of Financial Management, 702 Capitol Avenue, Suite 76, Frankfort, Kentucky 40601 (502) 564-2924. Additionally, The Kentucky Comprehensive Annual Financial Report for Fiscal Year 2004 and certain other fiscal years may be found on the Internet at:

http://finance.ky.gov/ourcabinet/caboff/ooc/cafr.htm

Only information contained on the Internet web page identified above is incorporated herein and no additional information that may be reached from such page by linking to any other page should be considered to be incorporated herein.

The Commission will enter into a Continuing Disclosure Agreement in order to enable the purchaser of the Bonds to comply with the provisions of Rule 15c2-12. See "CONTINUING DISCLOSURE" herein. In addition, ongoing financial disclosure regarding the Commonwealth will be available through the filing by the Commonwealth of two documents entitled *The Kentucky Comprehensive Annual Financial Report and Supplementary Information to the Kentucky Comprehensive Annual Financial Report* (or successor reports) with the NRMSIRs as required under Rule 15c2-12.

**Fiscal Year 2003**

The Commonwealth began Fiscal Year 2003 without a legislatively enacted budget for the Executive branch of government and operated under an Executive Spending Plan implemented by an Executive Order of the Governor. In the General Assembly's 2003 Regular Session, which concluded on March 25, 2003, the legislature enacted House Bill 269, which included a budget for the Executive branch of government for the 2003-2004 biennium. The General Assembly also passed separate legislation that effectively ratified all amounts previously spent under the Executive Spending Plan.

The Commonwealth's Government-Wide Financial Statements provide a broad view of the state's operations in a manner similar to a private-sector business. The Commonwealth's combined net assets (governmental and business-type activities) totaled $16.2 billion at the end of 2003, as compared to $15.4 billion at the end of the previous year. Over time, net assets may serve as a useful indicator of a government's financial position.

The largest portion of the Commonwealth's net assets $16.6 billion reflects its investment in capital assets (e.g. land, infrastructure, buildings and improvements and machinery and equipment), less any related debt used to acquire those assets that is still outstanding. The Commonwealth uses these capital assets to provide services to its citizens; therefore, these assets are not available for future spending.

An additional portion of the Commonwealth's net assets $1.65 billion is restricted and represents resources that are subject to either external restrictions or legislative restrictions on how they may be used. The remaining balance is unrestricted net assets. The unrestricted net assets which, if positive could be used at the Commonwealth's discretion, showed a negative balance of $(2.06) billion.

Therefore, no funds were available for discretionary purposes. A contributing factor to the negative balance is that liabilities are recognized on the government-wide statement of net assets when the obligation is incurred. Accordingly, the Commonwealth recognizes long-term liabilities (such as general bonded debt, compensated absences, unfunded employer pension cost, and contingent liabilities) on the statement of net assets.

The Commonwealth received program revenues of $7.7 billion and general revenues of $8.1 billion for total revenues of $15.8 billion during Fiscal Year 2003. Expenses for the Commonwealth during Fiscal Year 2003 were $15 billion, which resulted in a total increase of the Commonwealth's net assets in the amount of $770 million, net of contributions, transfers and special items.

During the fiscal year, the net assets of governmental activities increased by $724 million or 4.6 percent. Approximately 57 percent of the governmental activities' total revenue came from taxes, while 43 percent resulted from grants and contributions (including federal aid). Overall, program revenues were insufficient to cover program expenses for governmental activities. The net program expenses of these governmental activities were therefore supported by general revenues, mainly taxes.

The focus of the Commonwealth's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Commonwealth's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net resources available for spending at the end of a Fiscal Year.

At the end of the fiscal year, the Commonwealth's governmental funds reported combined ending fund balances of $2.16 billion, a decrease of $196 million in comparison with the prior year. Just over two-thirds ($1.47 billion or 68 percent) of this total amount constitutes unreserved fund balance, which is available for spending in the coming year. The remainder of fund balance is reserved to indicate that it is not available for new spending.

The General Fund is the chief operating fund of the Commonwealth. At the end of the fiscal year, the total fund balance reached $298 million, with an unreserved balance of $184 million. This compares to a General Fund unreserved balance of $(36) million as of June 30, 2002. An unreserved fund balance represents the excess of the assets of the General Fund over its liabilities and reserved fund balance accounts. Reservations of fund balances of governmental funds represent amounts that are not available for appropriation. Examples of fund balance reservations reported include reserves for encumbrances, inventories and capital outlay.

The fund balance of the Commonwealth's General Fund increased by $214 million during the fiscal year. This is a 253 percent increase from the prior year. The increase is the result of spending reduction efforts, lapses of appropriations, and an increased number of interfund transfers-in.

The Transportation Fund balance at June 30, 2003 totaled $439 million, a decrease of $114 million during the fiscal year. The decrease primarily relates to an accelerated program for the construction of road projects.

The Commonwealth's bonded debt decreased by $240 million to $3,165,223,000, a seven percent decrease during the fiscal year. No general obligation bonds were authorized or outstanding at June 30, 2003. The key factor in this decrease was the payment of principal on bonds outstanding and the absence of any new money bonds issued during Fiscal Year 2003.

**Fiscal Year 2004**

The Commonwealth's Government-Wide Financial Statements provide a broad view of the state's operations in a manner similar to a private-sector business. The Commonwealth's combined net assets (governmental and business-type activities) totaled $16.6 billion at the end of 2004, as compared to $16.2 billion at the end of the previous year.

At $17.4 billion, the largest portion of the Commonwealth's net assets is invested in capital assets (e.g. land, infrastructures, buildings and improvements and machinery and equipment), less any related debt used to acquire those assets that is still outstanding. The Commonwealth uses these capital assets to provide services to its citizens; therefore, these assets are not available for future spending.

The second largest portion of the Commonwealth's net assets, totaling $1.38 billion is restricted and represents resources that are subject to either external restrictions or legislative restrictions on how they may be used. The remaining balance is unrestricted net assets. The unrestricted net assets, which if positive could be used at the Commonwealth's discretion, showed a negative balance of $2.2 billion. Therefore, no funds were available for discretionary purposes. A contributing factor to the negative balance is that liabilities are recognized on the government-wide statement of net assets when the obligation is incurred. Accordingly, the Commonwealth recognizes long-term liabilities (such as general bonded debt, compensated absences, unfunded employer pension cost, and contingent liabilities) on the statement of net assets.

The Commonwealth received program revenues of $7.3 billion and general revenues of $8.5 billion for total revenues of $15.8 billion during Fiscal Year 2004. Expenses for the Commonwealth during Fiscal Year 2004 were $15.5 billion, which resulted in a total increase of the Commonwealth's net assets in the amount of $311 million, net of contributions, transfers and special items.

During the fiscal year, the net assets of governmental activities increased by $344 million or 2.10 percent. Approximately 54 percent of the governmental activities' total revenue came from taxes, while 35 percent resulted from grants and contributions (including federal aid). Overall, program revenues were insufficient to cover program expenses for governmental activities. Therefore, the net program expenses of these governmental activities were supported by general revenues, mainly taxes.

The focus of the Commonwealth's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Commonwealth's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net resources available for spending at the end of a Fiscal Year.

At the end of the fiscal year, the Commonwealth's governmental funds reported combined ending fund balances of $2.03 billion, a decrease of $74 million in comparison with the prior year. Approximately half ($999 million or 49 percent) of this total amount constitutes unreserved fund balance, which is available for spending in the coming year. The remainder of fund balance is reserved to indicate that it is not available for new spending.

The General Fund is the chief operating fund of the Commonwealth. At the end of the fiscal year, total fund balance reached $389 million, with an unreserved balance of $304 million. This compares to a General Fund unreserved balance of $184 million as of June 30, 2003. An unreserved fund balance represents the excess of the assets of the General Fund over its liabilities and reserved fund balance accounts. Reservations of fund balances of governmental funds represent amounts that are not available for appropriation. Examples of fund balance reservations reported include reserves for encumbrances, inventories and capital outlay.

The fund balance of the Commonwealth's General Fund increased by $94 million during the fiscal year. This is a 31.4 percent increase in net assets from the prior year. The increase is the result of spending reduction efforts, lapses of appropriations, and an increased number of interfund transfers-in.

The Transportation Fund balance at June 30, 2004 totaled $228 million, a decrease of $207 million during the fiscal year. The decrease primarily relates to an accelerated program for the construction of road projects.

The Commonwealth's bonded debt increased by $60 million to $3,225,431,000, a 1.90 percent increase during the fiscal year. No general obligation bonds were authorized or outstanding at June 30, 2004. The key factor in this increase was the issuance of new debt during Fiscal Year 2004.

**Fiscal Year 2005 (Unaudited)**

The Commonwealth began Fiscal Year 2005 without a legislatively enacted budget for the Executive branch of government and operated under quarterly Public Services Continuation Plans implemented by Executive Orders of the Governor. In the General Assembly's 2005 Regular Session, which concluded on March 22, 2005, the legislature enacted House Bill 267 (the "Budget Bill") which included a budget for the Executive branch of government for the 2005-2006 biennium and effectively ratified all amounts previously spent under the Public Services Continuation Plans.

Fiscal Year 2005 General Fund revenues totaled $7,645.0 million versus $6,997.6 million for the prior fiscal year, which represents an increase of 9.6 percent. Actual revenues for Fiscal Year 2005 were $195.1 million above the official revenue estimate on which the Budget Bill was based. Most major taxes exhibited across-the-board growth. Sales and use tax grew 6.0 percent ($147.4 million), the highest growth rate since 1996. Individual income taxes increased 8.6 percent ($239.9 million), while corporate income taxes increased by a sharp 57.8 percent ($175.3 million) due primarily to lower refund payments. Coal severance taxes rose 25 percent ($36.9 million) due to strong energy markets. Property tax receipts grew 5.3 percent ($23.8 million), while the lottery fell 7.2 percent ($12.5 million). Cigarette tax receipts rose 97.1 percent ($16.5 million) in the last month due to an increase in the rate of the tobacco tax and the imposition of a one-time floor stock tax as of May 31, 2005. Per pack taxes increased from 3 cents to 30 cents per pack. The ending General Fund undesignated balance was $468.8 million, which is $214.3 million above the budgeted undesignated balance. $90.2 million of the undesignated balance will be deposited in the Budget Reserve Trust Fund, bringing the balance in the fund to 1.5 percent of the estimated General Fund revenues in the Budget Bill for Fiscal Year 2006.

**Fiscal Year 2006 (Unaudited)**

On October 11, 2005, the Consensus Forecasting Group (the "Group") made a preliminary planning estimate for the Fiscal Year 2006 General Fund revenues of $8,184.9 million, an increase of $359.1 million over the estimate used in the Budget Bill. The Fiscal Year 2006 General Fund revenue estimate assumes 7.1 percent growth over the actual Fiscal Year 2005 General Fund revenues. These estimates exclude Phase I Tobacco Settlement Agreement ("MSA") payments, expected to be $91.3 million in Fiscal Year 2006. The MSA estimate decreased from prior estimates due to the Non-Participating Manufacturer's ("NPM") Adjustment.

Total General Fund revenues for September 2005 were $796.6 million, compared to $679.1 million during September 2004, an increase of 17.3 percent for the month. Fiscal year-to-date growth in the General Fund is 11.6 percent. Growth needed in the final nine months to meet the preliminary planning estimate is 5.1 percent. Much of the growth in September was due to the cigarette taxes that were imposed by the 2005 General Assembly. Cigarette taxes raised about $11.8 million more in revenue this September compared to last. Individual income tax receipts were up $5.8 million or 2.1 percent, and sales and use tax revenues rose $23 million or 11.1 percent. Corporation income taxes were up $77.4 million from last September, with revenues rising by 86.2 percent. The coal severance tax grew by $3.6 million or 24.6 percent, and the property tax rose by $5.1 million or 27.4 percent, principally due to a change in the timing of payments to the property tax on public service companies. Lottery receipts were $13 million, down by $6 million from the previous September.

**Investment Policy**

The Commonwealth's investments are governed by KRS 42.500 et seq. and KAR Title 200 Chapter 14. The State Investment Commission, comprised of the Governor, the Treasurer, Secretary of the Finance and Administration Cabinet and gubernatorial appointees of the Kentucky Banker's Association, is charged with the oversight of the Commonwealth's investment activities. The Commission is required to meet at least quarterly, and delegates day-to-day investment management to the Office of Financial Management.

At September 30, 2005, the Commonwealth's operating portfolio was approximately $3.88 billion in cash and securities. The composition of investments was as follows: U.S. treasury securities (11%); securities issued by agencies, corporations and instrumentalities of the United States Government, including mortgage backed securities and collateralized mortgage obligations (31%); repurchase agreements collateralized by the aforementioned (13%); municipal securities (6%); and corporate and asset backed securities, including money market securities (39%). The portfolio had a current yield of 3.96% and an effective duration of 0.81 years.

The Commonwealth's investments are currently categorized into three investment pools: Short-term, Intermediate-term and Bond Proceeds Pools. The purpose of these pools is to provide economies of scale that enhance yield, ease administration and increase accountability and control. The Short-term Pool consists primarily of General Fund and related accounts and provides liquidity to the remaining pools. The Intermediate-term Pool represents Agency Fund investments, state held component unit funds and fiduciary fund accounts held for the benefit of others by the Commonwealth. The Bond Proceeds Pool is where bond proceeds for capital construction projects are deposited until expended for their intended purpose.

The Commonwealth engages in selective derivative transactions. These transactions are entered into only with an abundance of caution and for specific hedge applications to minimize yield volatility in the portfolio. The State Investment Commission expressly prohibits the use of margin or other leveraging techniques. The Commonwealth executes a variety of transactions which may be considered derivative transactions, which include: the securities lending program, over-the-counter treasury options, interest rate swaps, mortgage backed securities, collateralized mortgage obligations and asset backed securities.

The Commonwealth has used over-the-counter treasury options since the mid-1980s to hedge and add value to the portfolio of treasury securities. These transactions involve the purchase and sale of put and call options on a covered basis, holding either cash or securities sufficient to meet the obligation should it be exercised. The State Investment Commission limits the total option commitment to no more than twenty percent of the total portfolio of treasury and agency securities. Historically, actual commitments have been less than ten percent of the portfolio.

The Commonwealth has had a securities lending program since the mid-1980s. The Commonwealth is able to enter into either a principal relationship or an agent relationship. In a principal relationship the Commonwealth reverses its treasury and agency securities in exchange for 102% of eligible collateral, marked to market daily. Eligible Collateral is defined as securities authorized for purchase pursuant to KRS 42.500. In an agent program the agent lends the Commonwealth's treasuries and agencies, takes the cash received from the loan and invests it in securities authorized for purchase pursuant to KRS 42.500. The income generated by these transactions is split between the agent and the Commonwealth. At the present time the Commonwealth has entered into an agent agreement that has a guarantee of 10 basis points of the average market value of securities in the program.

On June 20, 2003, the State Investment Commission adopted Resolution 03-03, which amended the Commonwealth's investment policy concerning asset-based interest rate swaps. The change modifies the exposure limits from a $200 million notional amount to a net market value approach, the absolute value of which cannot exceed $50 million for all counterparties. The Commonwealth engages in asset-based interest rate swaps to better manage its duration and to stabilize the volatility of interest income.

As of September 30, 2005, the Commonwealth had no asset-based interest rate swaps outstanding.

House Bill 5 of the First Extraordinary Session of 1997 was enacted on May 30, 1997. The Bill amended KRS 42.500 to authorize the purchase of additional investment securities with excess funds available for investment. The new classes of investment securities include: United States dollar denominated corporate securities, issued by foreign and domestic issuers, including sovereign and supranational governments, rated in one of the three highest categories by a nationally recognized rating agency, and asset backed securities rated in the highest category by a nationally recognized rating agency.

KAR Title 200 Chapter 14 provides, among other things that: corporate securities, inclusive of Commercial Paper, Banker's Acceptances and Certificates of Deposit are limited to twenty-five million per issuer and a stated final maturity of five years or less. Money market securities rated A1-P1 or higher are limited to 20% of any investment pool and when combined with corporate and asset backed securities (ABS) must not exceed 25% of any investment pool. United States Agency Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMO) are also limited to a maximum of 25% of any investment portfolio. ABS, MBS and CMO must have a weighted-average-life of four years or less at time of purchase.

**Commonwealth Debt Management**

**Management.** The Office of Financial Management ("OFM"), Finance and Administration Cabinet has central responsibility for the issuance, management, review and approval of all debt issued by the Commonwealth and its agencies. Table I lists state agencies which are active issuing entities. OFM is also responsible for the coordination and monitoring of cash needs relative to debt activity, debt service payments and the development of a comprehensive long-term debt plan. OFM serves as primary staff to the State Property and Buildings Commission, the Kentucky Asset/Liability Commission, and the Kentucky Local Correctional Facilities Construction Authority.

**Structure**. The Commonwealth's indebtedness is classified as either appropriation supported debt or non-appropriation supported debt.

Appropriation supported debt carries the name of the Commonwealth and is either (i) a general obligation of the State, or (ii) a project revenue obligation of one of its debt issuing agencies created by the Kentucky General Assembly to finance various projects which is subject to state appropriation for all or a portion of the debt service on the bonds.

General obligation bonds pledge the full faith, credit and taxing power of the Commonwealth for the repayment of the debt. The Kentucky Constitution requires voter approval by general referendum prior to the issuance of general obligation bonds in amounts exceeding $500,000. Kentucky has not issued general obligation bonds since 1966. The Commonwealth has no general obligation bonds outstanding.

Project revenue notes and bonds are issued by various debt issuing authorities of the Commonwealth. The revenues produced by the projects funded by the debt are pledged as security for repayment of the debt. Project revenues are not a direct obligation of the Commonwealth. Project revenues are, in some cases, derived partially or solely from biennial appropriations of the General Assembly. In other cases, the direct revenues generated from the project funded constitute the entire source of payment.

Non-appropriation or moral obligation debt carries the name of the Commonwealth for the benefit and convenience of other entities within the State. This type of indebtedness is a special obligation of the issuer, secured and payable solely from the sources pledged for the payment thereof and do not constitute a debt, liability, obligation or a pledge of the faith and credit of the Commonwealth. The General Assembly does not intend to appropriate any funds to fulfill the financial obligations represented by these types of indebtedness. In the event of a shortfall the issuer covenants to request from the Governor and the General Assembly sufficient amounts to pay debt service.

**Default Record**. The Commonwealth has never defaulted in the payment of principal or interest on its general obligation indebtedness or its project revenue obligations.

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## TABLE I
## ACTIVE DEBT ISSUING ENTITIES

| ENTITY | STATUTORY AUTHORITY/ PURPOSE | DEBT LIMITATIONS | RATING* |
|---|---|---|---|
| State Property and Buildings Commission | **KRS 56.450** Provide financing for capital construction projects and financing programs approved by the General Assembly. | Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly. | Aa3/A+/AA- |
| Kentucky Asset/Liability Commission | **KRS 56.860** Provide interim financing of capital projects and cash flow borrowings to meet working capital needs of the state. | Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly, exclusive of cash flow borrowings within a fiscal year. | Varies |
| Turnpike Authority of Kentucky | **KRS 175.410-175.990** Construct, maintain, repair, and operate Turnpike projects, resource recovery roads and economic development roads | Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly. | Aa3/A+/AA- |
| The State Universities (consisting of nine) | **KRS 56.495** Construct educational buildings and housing and dining facilities. | Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly. | Varies |
| Kentucky Housing Corporation | **KRS 198A** Make low interest mortgage loans and construction loans to increase the supply of housing for low and moderate income residents in the State. | Limited to $2.5 billion of debt outstanding | Aaa/AAA |
| Kentucky Infrastructure Authority | **KRS 224A** Provide financial assistance to local governments for the construction or refinancing of infrastructure facilities and to provide loans to industries for construction of pollution control facilities. | Revolving Fund programs cannot incur debt without appropriation of debt service by the General Assembly. Without legislative approval, other programs are limited to debt outstanding of $500 million. | Aa3/A+/AA- |
| Kentucky Higher Education Student Loan Corporation | **KRS 164A** Make guaranteed student loans to residents of the state to attend postsecondary institutions and to make loans to students attending postsecondary schools within the state. | Limited to $1.95 billion of debt outstanding. | Aaa/AA- |
| School Facilities Construction Commission | **KRS 157.611-157.665** Assist local school districts with the financing and construction of school buildings. Finance the construction of vocational education facilities. | Cannot incur debt without appropriation of debt service by General Assembly. | Aa3/A+/A |
| Kentucky Economic Development Finance Authority | **KRS 154** Issue industrial revenue bonds on behalf of industries, hospitals, and commercial enterprises in the state. Provide low interest loans to developing businesses. Provide financing and tax credits to manufacturing entities expanding or locating facilities in the state. | None. | Varies |
| Kentucky Local Correctional Facilities Construction Authority | **KRS 441.605-441.695** Provide an alternative method of constructing, improving, repairing and financing local jails. | Limited to the level of debt service supported by court fees pledged as repayment for the bonds. | AAA (Insured) |

*Ratings, where applicable, include Moody's, S&P and Fitch. S&P rates the Kentucky Infrastructure Authority's bonds which are paid from revenues (not appropriated funds), AA. Certain State Property and Buildings Commission Agency Fund Revenue Bonds may have ratings different than those identified above.

**Financings of the Commission**

**General.** The Commission has had outstanding obligations in several different forms, including tax and revenue anticipation notes and project notes. Project notes are issued as General Fund Series, Agency Fund Series, Road Fund Series and Federal Highway Trust Fund Series depending upon the appropriation fund source that is being used to fund the payments under the related financing/lease agreement. Each type of obligation, described below, is secured by the trust indenture to which such types of obligations relate, and holders of notes issued under a particular trust indenture do not have any claim on the pledged receipts of the Commission arising under any other trust indenture.

The holders of the Notes do not have a claim against the moneys pledged under the trust indenture related to any other project notes issued as General Fund Series, Agency Fund Series, Road Fund Series or Federal Highway Trust Fund Series. The indentures for each particular type of notes issued by the Commission generally allow the issuance of additional notes on parity with the outstanding notes of the same type. The Commission's outstanding obligations are described below.

**General Fund Tax and Revenue Anticipation Notes.** Since 1997, with the exception of 2003, the Commission has issued General Fund Tax and Revenue Anticipation Notes ("TRANs") on an annual basis corresponding with its fiscal year. The TRANs are payable from taxes and certain revenues collected by the Commonwealth in the Fiscal Year in which they are issued. The 2005 TRAN Series was issued on July 1, 2005 in the amount of $600,000,000 and will mature on June 28, 2006.

**Project Notes, General Fund Series**. The Commission from time to time issues separate series of project notes, the proceeds of which are used to fund capital projects (the "General Fund Project Notes") authorized by the General Assembly. All General Fund Project Notes are payable from payments to be received by the Commission under separate financing/lease agreements and, as to bond anticipation notes, the issuance of bonds by the State Property and Buildings Commission. These payments are ultimately dependent upon General Fund appropriations by the General Assembly of the Commonwealth. In addition to the Notes, the Commission has the following General Fund Project Notes outstanding.

| Project Notes | Amount Issued | Amount Outstanding as of November 1, 2005 |
|---|---|---|
| 2001 General Fund First Series | $37,450,000 | $17,475,000 |
| 2003 General Fund Series A | 171,260,000 | 84,485,000 |
| 2005 General Fund Series | 81,850,000 | 81,850,000 |
| Total | $290,560,000 | $183,810,000 |

The Commission on August 15, 2005, authorized the issuance of an aggregate principal amount not to exceed $750,000,000 of Project Notes, 2005 General Fund Second Series. These notes will be issued as needed, in a series of tranches, and will be supported by a standby liquidity facility.

**Project Notes, Agency Fund Series.** The Commission from time to time also issues separate series of project notes (the "Agency Fund Project Notes"), which are payable from payments to be received by the Commission under financing/lease agreements with various state agencies and from proceeds of bonds to be issued by the State Property and Buildings Commission or a state agency. The payments used to pay Agency Fund Project Notes are ultimately dependent upon Agency Fund appropriations by the General Assembly of the Commonwealth. As of November 1, 2005, $11,275,000 in principal amount of the 2005 Agency Fund Taxable First Series Project Notes is outstanding. The Commission on August 15, 2005, authorized the issuance of an aggregate principal amount not to exceed $250,000,000 of Project Notes, 2005 Agency Fund Second Series. These notes will be issued as needed, in a series of tranches that will not be reoffered.

**Project Notes, Road Fund Series**. There are currently no Road Fund Project Notes outstanding.

**Project Notes, Federal Highway Trust Fund Series**. The Commission is authorized to issue notes which are payable from payments to be received by the Commonwealth of Kentucky Transportation Cabinet from the Federal Highway Administration. Amounts used to pay those notes are ultimately dependent upon receipt of federal highway funds. As of November 1, 2005, $136,425,000 principal amount of the 2005 Federal Highway Trust Fund First Series Project Notes remains outstanding.

**Future Financings.** The 2005 Kentucky General Assembly authorized debt financing for projects totaling $2,056,315,300 to support various capital initiatives of the Commonwealth. Of the total authorization, $1,204,589,300 is General Fund supported, $251,726,000 is Agency Restricted Fund supported, $450,000,000 is Road Fund supported and $150,000,000 is Federal Highway Trust Fund supported (Grant Anticipation Revenue Vehicle Bonds).

Except for a $225,000,000 Road Fund supported authorization, the Notes complete the financing plans for the total authorization (excluding the General Fund supported School Facilities Construction Commission authorization). The Commission or another Authority may finance the remaining Road Fund authorization prior to June 30, 2006.

The authorization to issue notes for the purposes described above is in addition to the authority to issue refunding bonds to refund outstanding issues. The Kentucky General Assembly may authorize debt financing to support various capital initiatives of the Commonwealth in future budgets.

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## EXHIBIT D

## BOOK-ENTRY-ONLY SYSTEM

The Notes initially will be issued solely in book-entry-only form to be held in the book-entry-only system maintained by The Depository Trust Company ("DTC"), New York, New York. So long as such book-entry-only system is used, only DTC will receive or have the right to receive physical delivery of Notes and, except as otherwise provided herein with respect to tenders by Beneficial Owners (as hereinafter defined) of beneficial ownership interests, Beneficial Owners will not be or be considered to be, and will not have any rights as, owners or holders of the Notes under the Resolution.

The following information about the book-entry-only system applicable to the Notes has been supplied by DTC. Neither the Commission nor the Trustee makes any representations, warranties or guarantees with respect to its accuracy or completeness.

DTC will act as securities depository for the Notes. The Securities will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Note certificate will be issued for each maturity of the Notes, in the aggregate principal amount of the Notes and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Notes on DTC's records. The ownership interest of each actual purchaser of each Note ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Notes are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners.

Beneficial Owners will not receive certificates representing their ownership interests in Notes, except in the event that use of the book-entry system for the Notes is discontinued.

To facilitate subsequent transfers, all Notes deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Notes may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Notes, such as redemptions, tenders, defaults, and proposed amendments to the Note documents. For example, Beneficial Owners of Notes may wish to ascertain that the nominee holding the Notes for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Trustee and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Notes are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Notes unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Commission as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and interest payments on the Notes will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Commission or the Trustee, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with bonds held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such Participant and not of DTC or its nominee, the Trustee or the Commission, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Commission or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Notes at any time by giving reasonable notice to the Commission or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, Note certificates are required to be printed and delivered.

The Commission may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Note certificates will be printed and delivered.

NEITHER THE COMMISSION NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO ANY DIRECT PARTICIPANT, INDIRECT PARTICIPANT OR ANY BENEFICIAL OWNER OR ANY OTHER PERSON NOT SHOWN ON THE REGISTRATION BOOKS OF THE TRUSTEE AS BEING A HOLDER WITH RESPECT TO: (1) THE BONDS; (2) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT; (3) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL OR REDEMPTION PRICE OF OR INTEREST ON THE BONDS; (4) THE DELIVERY BY ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY NOTICE TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF THE INDENTURE TO BE GIVEN TO HOLDERS; (5) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE BONDS; OR (6) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS HOLDER.

Each Beneficial Owner for whom a Direct Participant or Indirect Participant acquires an interest in the Notes, as nominee, may desire to make arrangements with such Direct Participant or Indirect Participant to receive a credit balance in the records of such Direct Participant or Indirect Participant, to have all notices of redemption or other communications to or by DTC which may affect such Beneficial Owner forwarded in writing by such Direct Participant or Indirect Participant, and to have notification made of all debt service payments.

Beneficial Owners may be charged a sum sufficient to cover any tax, fee, or other governmental charge that may be imposed in relation to any transfer or exchange of their interests in the Notes.

The Commission cannot and does not give any assurances that DTC, Direct Participants, Indirect Participants or others will distribute payments of debt service on the Notes made to DTC or its nominee as the registered owner, or any redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or that DTC, Direct Participants or Indirect Participants will serve and act in the manner described in this Official Statement.

The information in this "EXHIBIT D" concerning DTC and DTC's book-entry system has been obtained from sources that the Commission believes to be reliable, but the Commission takes no responsibility for the accuracy thereof.

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**EXHIBIT E**

**FORM OF BOND COUNSEL OPINION FOR THE NOTES**

[Date of Delivery]

Kentucky Asset/Liability Commission
Frankfort, Kentucky

Re: Kentucky Asset/Liability Commission University of Kentucky General Receipts Project Notes, 2005 Series A

We have acted as bond counsel in connection with the issuance by the Kentucky Asset/Liability Commission, an independent agency and constituted authority of the Commonwealth of Kentucky (the "Issuer"), of its University of Kentucky General Receipts Project Notes, 2005 Series A in the amount of $107,540,000 (the "Project Notes").

The Project Notes are authorized to be issued pursuant to the Constitution and laws of the Commonwealth of Kentucky (the "Commonwealth"), including particularly Sections 56.860 et seq. of the Kentucky Revised Statutes (the "Act"), a Resolution adopted by the Issuer on October 17, 2005 (the "Resolution"), and a Trust Indenture (the "Indenture") dated as of November 1, 2005 between the Issuer and U.S. Bank National Association having offices in Atlanta, Georgia, as trustee (the "Trustee").

We have examined such portions of the Constitution, Statutes and laws of the United States, the Constitution, Statutes and laws of the Commonwealth, and such applicable court decisions, regulations, rulings and opinions as we have deemed necessary or relevant for the purposes of the opinions set forth below.

We have also examined records and the transcript of proceedings relating to the authorization and issuance of the Project Notes, including a specimen Project Note, the Financing/Lease Agreement (the "Financing Agreement") dated as of November 1, 2005 among the Issuer, the Finance and Administration Cabinet of the Commonwealth (the "Cabinet") and the University of Kentucky (the "University"). We have also made such investigation as we have deemed necessary for the purposes of such opinion, and relied upon certificates of officials of the Commonwealth, the Cabinet and the Issuer as to certain factual matters.

Based upon the foregoing, it is our opinion, under the law existing on the date of this opinion, that:

1. The Issuer is an independent agency and constituted authority of the Commonwealth, duly organized and validly existing under the laws of the Commonwealth and has the legal right and authority to issue the Project Notes.

2. The Indenture, the Financing Agreement, and the Resolution have been duly authorized, executed and delivered by the Issuer and the Financing Agreement has been duly authorized, executed and delivered by the Cabinet and the University and are each valid and binding obligations of the Issuer, the Cabinet and the University, as applicable, enforceable in accordance with their respective terms.

3. The Project Notes have been duly and validly authorized, executed and delivered and constitute valid and binding limited and special obligations of the Issuer enforceable in accordance with their terms.

4. The Project Notes are payable as to principal, premium, if any, and interest from and are secured by a pledge of and a first lien on the Pledged Receipts, as defined in the Indenture. The Project Notes do not pledge the general credit or taxing power, if any, of the Commonwealth, the Issuer, the Cabinet, the University or any other agency or political subdivision of the Commonwealth.

5. The Project Notes are not secured by a pledge of or lien on the properties constituting the Project, as defined in the Indenture, but are payable as to principal and interest solely and only from and are secured by the Pledged Receipts. The ability of the University to make payments under the Financing Agreement is dependent upon legislative appropriations to the University, which has leased the Project for an initial term ending on the final maturity date of the Project Notes.

6. Under the laws, regulations, rulings and judicial decisions in effect as of the date hereof, interest on the Project Notes is excludable from gross income for Federal income tax purposes, pursuant to the Internal Revenue Code of 1986, as amended (the "Code"). Furthermore, interest on the Project Notes will not be treated as a specific item of tax preference, under Section 57(a)(5) of the Code, in computing the alternative minimum tax for individuals and corporations. In rendering the opinions in this paragraph, we have assumed continuing compliance with certain covenants designed to meet the requirements of Section 103 of the Code. We express no other opinion as to the federal tax consequences of purchasing, holding or disposing of the Project Notes.

7. Interest on the Project Notes is exempt from income taxation and the Project Notes are exempt from ad valorem taxation by the Commonwealth and any of its political subdivisions.

Our opinion set forth above is subject to the qualification that the enforceability of the Indenture, the Resolution, the Financing Agreement, the Project Notes and agreements relating thereto may be limited by bankruptcy, reorganization, moratorium, insolvency, or other similar laws relating to or affecting the enforcement of creditors' rights, and to the exercise of judicial discretion in accordance with general equitable principles.

In rendering our opinion as to the due authorization, execution and delivery of the Financing Agreement by the Cabinet and the University, we have relied on opinions of counsel to the Cabinet and the University.

Very truly yours,

# EXHIBIT F

## FORM OF BOND INSURANCE POLICY

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# FGIC

**Financial Guaranty Insurance Company**
125 Park Avenue
New York, NY 10017
T 212·312·3000
T 800·352·0001

# Municipal Bond
# New Issue Insurance Policy

| | |
|---|---|
| **Issuer:** | **Policy Number:** |
| | **Control Number:** 0010001 |
| **Bonds:** | **Premium:** |



Financial Guaranty Insurance Company ("Financial Guaranty"), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy, hereby unconditionally and irrevocably agrees to pay to U.S. Bank Trust National Association or its successor, as its agent (the "Fiscal Agent"), for the benefit of Bondholders, that portion of the principal and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Guaranty will make such payments to the Fiscal Agent on the date such principal or interest becomes Due for Payment or on the Business Day next following the day on which Financial Guaranty shall have received Notice of Nonpayment, whichever is later. The Fiscal Agent will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid by reason of Nonpayment by the Issuer but only upon receipt by the Fiscal Agent, in form reasonably satisfactory to it, of (i) evidence of the Bondholder's right to receive payment of the principal or interest Due for Payment and (ii) evidence, including any appropriate instruments of assignment, that all of the Bondholder's rights to payment of such principal or interest Due for Payment shall thereupon vest in Financial Guaranty. Upon such disbursement, Financial Guaranty shall become the owner of the Bond, appurtenant coupon or right to payment of principal or interest on such Bond and shall be fully subrogated to all of the Bondholder's rights thereunder, including the Bondholder's right to payment thereof.

This Policy is non-cancellable for any reason. The premium on this Policy is not refundable for any reason, including the payment of the Bonds prior to their maturity. This Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Bond.

As used herein, the term "Bondholder" means, as to a particular Bond, the person other than the Issuer who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof. "Due for Payment" means, when referring to the principal of a Bond, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity and means, when referring to interest on a Bond, the stated date for payment of interest. "Nonpayment" in respect of a Bond means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all

FGIC

Financial Guaranty Insurance Company
125 Park Avenue
New York, NY 10017
T 212·312·3000
T 800·352·0001

# Municipal Bond
# New Issue Insurance Policy

principal and interest Due for Payment on such Bond. "Notice" means telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from a Bondholder or a paying agent for the Bonds to Financial Guaranty. "Business Day" means any day other than a Saturday, Sunday or a day on which the Fiscal Agent is authorized by law to remain closed.

In Witness Whereof, Financial Guaranty has caused this Policy to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.



**President**

**Effective Date:** **Authorized Representative**

U.S. Bank Trust National Association, acknowledges that it has agreed to perform the duties of Fiscal Agent under this Policy.

**Authorized Officer**

FGIC

**Financial Guaranty Insurance Company**
125 Park Avenue
New York, NY 10017
T 212·312·3000
T 800·352·0001

# Endorsement
## To Financial Guaranty Insurance Company Insurance Policy

**Policy Number:** **Control Number:** 0010001

SPECIMEN

It is further understood that the term "Nonpayment" in respect of a Bond includes any payment of principal or interest made to a Bondholder by or on behalf of the issuer of such Bond which has been recovered from such Bondholder pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

**President**

**Effective Date:** **Authorized Representative**

**Acknowledged as of the Effective Date written above:**

**Authorized Officer**
**U.S. Bank Trust National Association, as Fiscal Agent**

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KENTUCKY ASSET/LIABILITY COMMISSION • UNIVERSITY OF KENTUCKY GENERAL RECEIPTS PROJECT NOTES, 2005 SERIES A

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