

**University of Kentucky
Athletic Association
A Component Unit of the University of Kentucky**

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors
University of Kentucky
Athletic Association
Lexington, Kentucky

We have audited the accompanying basic financial statements of the University of Kentucky Athletic Association (Association), a not-for-profit corporation affiliated with and a component unit of the University of Kentucky, as of and for the years ended June 30, 2010 and 2009, as listed in the table of contents. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Association as of June 30, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

BKD, LLP

September 30, 2010

Management's Discussion and Analysis

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

Financial Highlights

- The financial statements for FY 2009-2010 report a strong financial condition at June 30, 2010. Financial operations were in accordance with the revenue expectations and the approved budget plan.
- Total assets increased \$5.3 million or 20.4%. The most significant components of the fluctuation were a \$5.7 million increase in cash and cash equivalents, offset by a \$508,000 decrease in inventories and other assets.
- Total liabilities increased \$1.6 million or 9.9%. Deferred revenue increased \$1.0 million and long term liabilities increased \$642,000.
- Unrestricted net assets increased \$3.6 million or 47.1% caused by operating and nonoperating revenues in excess of operating expenses and transfers to the University.
- Operating revenues increased \$6.8 million to \$63.7 million.
- Operating expenses increased \$9.9 million to \$67.6 million.
- Nonoperating revenues increased \$14.5 million, primarily due to a \$2.8 million increase in transfers from the University for noncapital purposes and a \$9.8 million decrease in transfers to the University for capital purposes.

Using the Annual Report

This financial report consists of three financial statements: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*.

One of the most important questions asked about the Association's finances is whether the Association is better off as a result of the year's activities. One key to answering this question is the financial statements of the Association. The Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and the Statement of Cash Flows present financial information on the Association in a format similar to that used by corporations and present a long-term view of the Association's finances. The Association's net assets (the difference between assets and liabilities) are one sign of the Association's financial health. Over time, increases or decreases in net assets indicate the improvement or erosion of the Association's condition, when considered in conjunction with non-financial factors such as the graduation rates of its student athletes and the success of its athletic teams on the field.

The Statement of Net Assets includes all assets and liabilities. It is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

The Statement of Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. GASB 35 requires gifts and endowment and investment income to be classified as nonoperating revenues. The utilization of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

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

Reporting Entity

The University of Kentucky Athletic Association is a not-for-profit Kentucky corporation, established to promote athletics and physical culture for students at the University of Kentucky (the University) and residents of the Commonwealth of Kentucky. The Association is considered to be an affiliate and component unit of the University because all Board members are related to the University as faculty, staff or alumni and/or are appointed by the President of the University, and certain officers of the Association are officers of the University.

Condensed Financial Information

Statements of Net Assets

	<u>2010</u>	<u>2009</u>	<u>2008</u>
ASSETS			
Current assets	\$ 28,822,817	\$ 23,644,731	\$ 19,685,313
Capital assets	1,917,862	1,854,524	46,681,117
Other noncurrent assets	249,342	237,911	3,485,461
Total assets	<u>30,990,021</u>	<u>25,737,166</u>	<u>69,851,891</u>
LIABILITIES			
Current liabilities	16,923,615	15,980,849	15,956,088
Noncurrent liabilities	641,858	-	36,450,000
Total liabilities	<u>17,565,473</u>	<u>15,980,849</u>	<u>52,406,088</u>
NET ASSETS			
Invested in capital assets, net of related debt	1,917,862	1,854,524	12,086,742
Restricted			
Expendable	305,927	289,661	367,213
Unrestricted	11,200,759	7,612,132	4,991,848
Total net assets	<u>\$ 13,424,548</u>	<u>\$ 9,756,317</u>	<u>\$ 17,445,803</u>

Assets. As of June 30, 2010, the Association's assets totaled \$31.0 million. Cash and cash equivalents represented the Association's largest asset, totaling \$24.9 million or 80.3% of total assets. Inventories and other assets totaled \$3.6 million or 11.6%.

Total assets increased \$5.3 million or 20.4% primarily due to a \$5.7 million increase in cash and cash equivalents resulting principally from operating revenues and grants from the University exceeding operating expenses.

Liabilities. At June 30, 2010, the Association's liabilities totaled \$17.6 million. Deferred revenue, primarily comprised of advance sales of football tickets and reserved parking, totaled \$14.3 million and represented 81.3% of total liabilities.

Total liabilities increased \$1.6 million during the year ended June 30, 2010. Deferred revenue increased \$1.0 million due to higher advance sales of football tickets and reserved parking caused by price increases. Long term liabilities increased \$642,000 due to recognition of a liability for coach longevity and retention bonuses.

Net Assets. Net assets at June 30, 2010, totaled \$13.4 million, or 43.2% of total assets. Invested in capital assets, net of related debt, totaled \$1.9 million or 14.2% of total net assets. Restricted net assets totaled \$306,000 or 2.2% of total net assets. Unrestricted net assets accounted for \$11.2 million or 83.6% of total net assets.

Total net assets increased \$3.7 million during the year ended June 30, 2010, driven by an increase of \$3.6 million in unrestricted net assets caused by operating and nonoperating revenues in excess of operating expenses and transfers to the University.

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

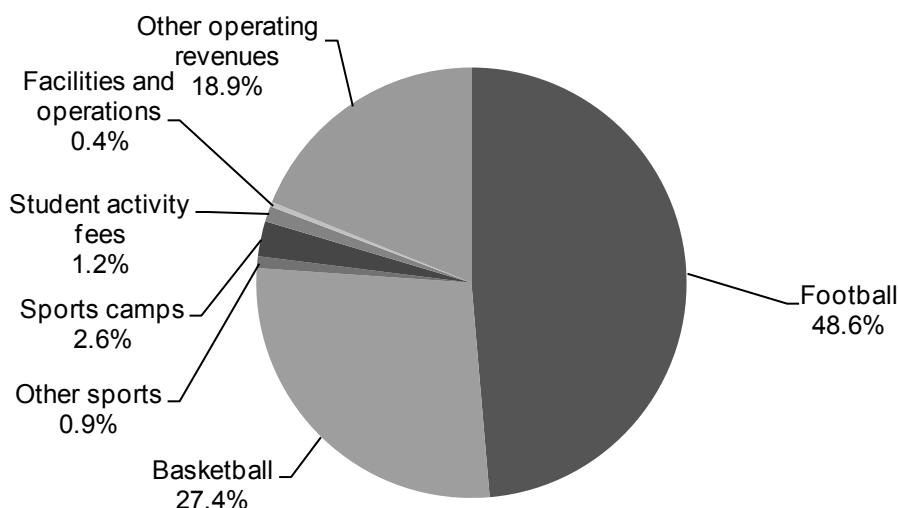
- Total assets decreased \$44.1 million or 63.2% primarily due to a \$44.0 million decrease in capital assets, net of depreciation, as a result of the transfer of the W. T. Young Library and associated fixed equipment and land improvements from the Association to the University due to the refunding of the LFUCG Bonds Series 1998 by the University.
- Total liabilities decreased \$36.4 million. Long term liabilities decreased \$37.8 million because of the payment of the maturities and the defeasement of the noncurrent portion of the LFUCG bonds. An increase in deferred revenue of \$1.2 million due to higher sales of advance football tickets and reserved parking partially offset this decrease.
- Total net assets decreased \$7.7 million, driven by a decrease of \$10.2 million in capital assets, net of related debt, caused by the transfer of the W. T. Young Library from the Association to the University. The transfer was offset by an increase in unrestricted net assets of \$2.6 million caused by operating and nonoperating revenues in excess of operating expenses and transfers to the University.

Statements of Revenues, Expenses and Changes in Net Assets

	<u>2010</u>	<u>2009</u>	<u>2008</u>
OPERATING REVENUES			
Football	\$ 30,908,321	\$ 25,119,768	\$ 24,683,861
Basketball	17,440,345	15,508,292	15,648,394
Other sports	558,167	383,515	427,442
Total sports	<u>48,906,833</u>	<u>41,011,575</u>	<u>40,759,697</u>
Sports camps	1,689,513	1,653,986	1,691,558
Student activity fees	738,194	686,003	569,136
Facilities and operations	226,128	1,905,765	264,124
Other operating revenue, primarily media rights and sponsorships	12,091,660	11,599,589	12,646,636
Total operating revenues	<u>63,652,328</u>	<u>56,856,918</u>	<u>55,931,151</u>
OPERATING EXPENSES			
Football	13,354,165	12,470,120	11,197,451
Basketball	11,166,116	8,182,263	8,423,872
Other sports	14,366,104	13,442,534	12,974,017
Total sports	<u>38,886,385</u>	<u>34,094,917</u>	<u>32,595,340</u>
Sports camps	1,650,044	1,632,972	1,671,588
Facilities and operations	8,253,110	8,468,691	7,642,062
Administrative and general	18,205,416	12,919,237	14,076,959
Depreciation	555,336	541,996	2,161,461
Total operating expenses	<u>67,550,291</u>	<u>57,657,813</u>	<u>58,147,410</u>
NET LOSS FROM OPERATIONS	<u>(3,897,963)</u>	<u>(800,895)</u>	<u>(2,216,259)</u>
NONOPERATING REVENUES (EXPENSES)			
Royalties/license fees	1,487,572	1,809,985	1,692,466
Investment income	55,265	79,329	512,064
Grants from the University of Kentucky for noncapital purposes	9,548,068	6,767,560	8,161,828
Interest on capital asset-related debt	-	(626,640)	(1,898,052)
Net nonoperating revenues and expenses	<u>11,090,905</u>	<u>8,030,234</u>	<u>8,468,306</u>
Net income before other revenues, expenses, gains, or losses	<u>7,192,942</u>	<u>7,229,339</u>	<u>6,252,047</u>
Grants to the University of Kentucky for capital purposes	(3,511,737)	(13,270,112)	(4,506,196)
Other	(12,974)	(1,648,713)	(49,392)
Total other expenses	<u>(3,524,711)</u>	<u>(14,918,825)</u>	<u>(4,555,588)</u>
Total increase (decrease) in net assets	3,668,231	(7,689,486)	1,696,459
Net assets, beginning of year	<u>9,756,317</u>	<u>17,445,803</u>	<u>15,749,344</u>
Net assets, end of year	<u>\$ 13,424,548</u>	<u>\$ 9,756,317</u>	<u>\$ 17,445,803</u>

2010. Total operating revenues were \$63.7 million for the year ended June 30, 2010. The most significant sources of operating revenue for the Association were football (48.6%), basketball (27.4%), and other operating revenues, primarily media rights and sponsorships (18.9%). Operating revenues increased \$6.8 million primarily due to increases in football revenue of \$5.8 million and basketball revenue of \$1.9 million caused mainly by TV/broadcasting income from the SEC resulting from a new contract for television broadcasting rights. The increases were offset by a decrease in facilities and operations revenues of \$1.7 million caused by the receipt of a legal settlement in prior year.

TOTAL OPERATING REVENUES

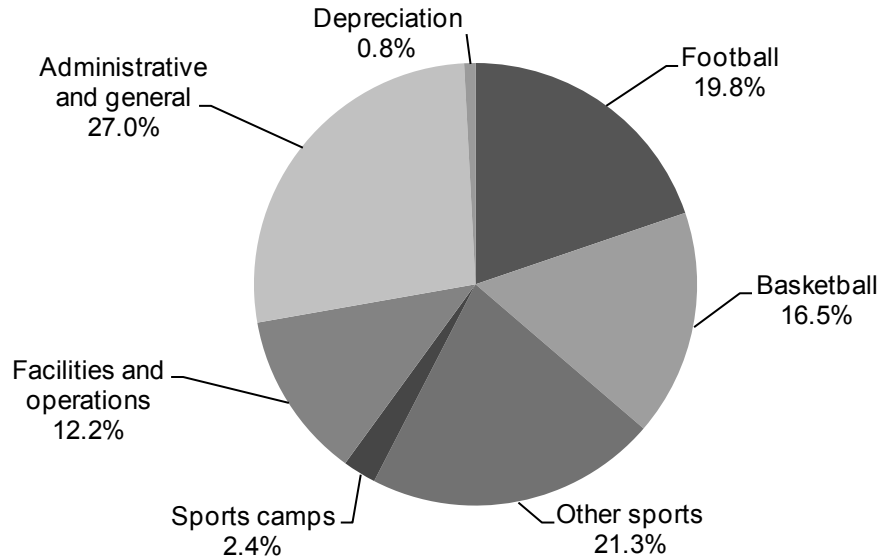


Operating expenses, including \$555,000 of depreciation, totaled \$67.6 million. Of this amount, \$38.9 million or 57.5% was used in direct support of sports programs and \$18.2 million or 26.9% supported the Association’s administrative operations.

Operating expenses increased \$9.9 million or 17.2% primarily caused by increases in administrative and general expenses of \$5.3 million or 40.9% and sports related expenses of \$4.8 million or 14.1%. Administrative and general expenses increased primarily due to the settlement of a lawsuit with the former men’s basketball head coach. Sports related expenses increased mainly due to increased coaches’ salaries caused by head coach and other staffing changes in basketball and football.

The Association’s expenses for operating sports programs include scholarship expenses of \$8.9 million. These scholarships are funded by a transfer from the University of Kentucky K Fund (the K Fund).

TOTAL OPERATING EXPENSES



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

- Total operating revenues were \$56.9 million. The most significant sources of operating revenue for the Association were football (44.2%), basketball (27.3%), and other operating revenues, primarily media rights and sponsorships (20.4%). Operating revenues increased \$926,000 primarily due to increases in facilities and operations revenue of \$1.6 and \$252,000 in sports revenue. The increases were offset by a decrease in other operating revenues of \$1.0 million from a one-time sponsorship payment received the prior year.
- Operating expenses decreased \$490,000 or 0.8% primarily caused by decreases in depreciation of \$1.6 million or 74.9% and administrative and general expenses of \$1.2 million or 8.2%, offset by an increase in sports related expenses of \$1.5 million or 4.6%. Several factors affected operating expenses. Depreciation decreased due to the transfer of the W. T. Young Library to the University because it was expensed by the University. Administrative and general expenses decreased primarily because of legal costs involved with settling a long-standing lawsuit from the renovation of Commonwealth Stadium. Sports operating expenses increased mainly because of an increase of \$1.3 million in football expenses due to higher coaches' salaries, guarantees and scholarship expenses.

Statement of Cash Flows

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

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

	<u>2010</u>	<u>2009</u>	<u>2008</u>
CASH PROVIDED (USED) BY :			
Operating activities	\$ (1,273,955)	\$ 627,727	\$ 524,990
Noncapital financing activities	11,035,640	8,586,611	9,863,360
Capital and related financing activities	(4,140,409)	(9,369,619)	(8,573,089)
Investing activities	<u>43,834</u>	<u>3,326,879</u>	<u>553,223</u>
Net increase in cash and cash equivalents	5,665,110	3,171,598	2,368,484
Cash and cash equivalents, beginning of year	<u>19,264,450</u>	<u>16,092,852</u>	<u>13,724,368</u>
Cash and cash equivalents, end of year	<u><u>\$24,929,560</u></u>	<u><u>\$ 19,264,450</u></u>	<u><u>\$16,092,852</u></u>

2010. The major source of funds included in operating activities is revenue from sports of \$50.4 million for the year ended June 30, 2010. The largest cash payments for operating activities were made to suppliers and for salaries and wages of approximately \$39.0 million and \$26.9 million, respectively. Cash used by operating activities increased \$1.9 million due to an increase of \$5.2 million in salaries and wages, an increase of \$3.7 million in payments to suppliers and a \$2.0 million decrease in other receipts, offset by a \$9.0 million increase in sports revenues.

During the year ended June 30, 2010, cash receipts in the noncapital financing activities group were generated by grants from the K Fund of \$8.9 million for athletic scholarships and \$4.6 million for student athlete support services offset by transfers of \$4.0 million to the University, primarily in support of non-athletic scholarships. In addition, royalties and license fees provided cash of \$1.5 million.

Cash used by capital and related financing activities is primarily expended on grants to the University to fund the construction and acquisition of capital assets, mainly through principal and interest payments on debt. In addition, cash is also used for the direct purchase of capital assets.

During the year ended June 30, 2010, cash provided by investing activities reflects proceeds from sales and maturities of investments of \$358,000 and interest and dividend income on investments of \$32,000, net of cash used to purchase investments of \$346,000.

2009 Versus 2008. Cash increased \$3.2 million primarily due to cash provided by \$8.6 million noncapital financing activities, \$3.4 million investing activities and operating activities of \$628,000, offset by cash used by capital and related financing activities of \$9.4 million.

Capital Asset and Debt Administration

Capital Assets. Capital assets, net of accumulated depreciation, of \$1.9 million at June 30, 2010, were comparable to the prior year end. Significant changes to capital assets during FY 2009-2010 included:

Capital asset additions	\$ 636,000
Capital asset disposals, net	\$ (17,000)
Current year depreciation expense	\$(555,000)

Debt. As of June 30, 2010, the Association has no debt.

Factors Impacting Future Periods

The Association is funded primarily by sales of tickets to athletic events and support from contributors. During fiscal year 2010, ticket sales and donations have increased. Should sales of tickets or donations ever decrease, it could impact the Association's future financial results. For fiscal year 2011, ticket price increases for football and men's basketball have been approved and are estimated to increase revenues by approximately \$6.7 million.

**UNIVERSITY OF KENTUCKY ATHLETIC ASSOCIATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF NET ASSETS
JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$24,929,560	\$19,264,450
Accounts receivable	316,888	296,032
Inventories and other assets	3,576,369	4,084,249
Total current assets	<u>28,822,817</u>	<u>23,644,731</u>
Noncurrent Assets		
Endowment investments	249,342	237,911
Capital assets, net	1,917,862	1,854,524
Total noncurrent assets	<u>2,167,204</u>	<u>2,092,435</u>
Total assets	<u>30,990,021</u>	<u>25,737,166</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	2,508,048	2,564,485
Deferred revenue	14,300,954	13,289,040
Due to the University of Kentucky	114,613	127,324
Total current liabilities	<u>16,923,615</u>	<u>15,980,849</u>
Noncurrent Liabilities		
Long term liabilities	641,858	-
Total noncurrent liabilities	<u>641,858</u>	<u>-</u>
Total liabilities	<u>17,565,473</u>	<u>15,980,849</u>
NET ASSETS		
Invested in capital assets, net of related debt	1,917,862	1,854,524
Restricted expendable	305,927	289,661
Unrestricted	11,200,759	7,612,132
Total net assets	<u>\$13,424,548</u>	<u>\$ 9,756,317</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY ATHLETIC ASSOCIATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
OPERATING REVENUES		
Sports:		
Football	\$30,908,321	\$25,119,768
Basketball	17,440,345	15,508,292
Other sports	558,167	383,515
Total sports	<u>48,906,833</u>	<u>41,011,575</u>
Sport camps	1,689,513	1,653,986
Student activity fees	738,194	686,003
Facilities and operations	226,128	1,905,765
Other operating revenues, primarily media rights and sponsorships	12,091,660	11,599,589
Total operating revenues	<u>63,652,328</u>	<u>56,856,918</u>
OPERATING EXPENSES		
Sports:		
Football	13,354,165	12,470,120
Basketball	11,166,116	8,182,263
Other sports	14,366,104	13,442,534
Total sports	<u>38,886,385</u>	<u>34,094,917</u>
Sport camps	1,650,044	1,632,972
Facilities and operations	8,253,110	8,468,691
Administrative and general	18,205,416	12,919,237
Depreciation	555,336	541,996
Total operating expenses	<u>67,550,291</u>	<u>57,657,813</u>
Net income (loss) from operations	<u>(3,897,963)</u>	<u>(800,895)</u>
NONOPERATING REVENUES (EXPENSES)		
Royalties/license fees	1,487,572	1,809,985
Investment income	55,265	79,329
Grants (to) from the University of Kentucky for noncapital purposes	9,548,068	6,767,560
Interest on capital asset-related debt	-	(626,640)
Net nonoperating revenues (expenses)	<u>11,090,905</u>	<u>8,030,234</u>
Net income (loss) before other revenues, expenses, gains, or losses	<u>7,192,942</u>	<u>7,229,339</u>
Grants (to) from the University of Kentucky for capital purposes	(3,511,737)	(13,270,112)
Other	(12,974)	(1,648,713)
Total other revenues (expenses)	<u>(3,524,711)</u>	<u>(14,918,825)</u>
Increase (decrease) in net assets	3,668,231	(7,689,486)
NET ASSETS, beginning of year	<u>9,756,317</u>	<u>17,445,803</u>
NET ASSETS, end of year	<u>\$13,424,548</u>	<u>\$ 9,756,317</u>

See notes to financial statements.

**UNIVERSITY OF KENTUCKY ATHLETIC ASSOCIATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Revenues from sports	\$ 50,430,175	\$ 41,422,564
Payments to vendors and contractors	(38,960,585)	(35,211,996)
Salaries, wages and benefits reimbursements to the University of Kentucky	(26,925,500)	(21,763,229)
Other receipts (payments)	<u>14,181,955</u>	<u>16,180,388</u>
Net cash provided (used) by operating activities	<u>(1,273,955)</u>	<u>627,727</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Royalties/license fees	1,487,572	1,809,985
Grants (to) from the University of Kentucky	<u>9,548,068</u>	<u>6,776,626</u>
Net cash provided (used) by noncapital financing activities	<u>11,035,640</u>	<u>8,586,611</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	(3,524,448)	31,250,868
Purchases of capital assets	(615,961)	(270,277)
Payments to refunding bond agents	-	(38,090,250)
Principal paid on capital debt and leases	-	(1,320,000)
Interest paid on capital debt and leases	-	(939,960)
Net cash provided (used) by capital and related financing activities	<u>(4,140,409)</u>	<u>(9,369,619)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	357,866	5,767,097
Interest and dividends on investments	31,562	150,588
Purchase of investments	<u>(345,594)</u>	<u>(2,590,806)</u>
Net cash provided (used) by investing activities	<u>43,834</u>	<u>3,326,879</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>5,665,110</u>	<u>3,171,598</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>19,264,450</u>	<u>16,092,852</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 24,929,560</u>	<u>\$ 19,264,450</u>
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	\$ (3,897,963)	\$ (800,895)
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Depreciation expense	555,336	541,996
Change in assets and liabilities:		
Accounts receivable, net	(20,856)	(57,002)
Inventories and other assets	507,880	(730,818)
Accounts payable and accrued liabilities	(72,124)	460,189
Deferred revenue	1,011,914	1,214,257
Long term liabilities	<u>641,858</u>	<u>-</u>
Net cash provided (used) by operating activities	<u>\$ (1,273,955)</u>	<u>\$ 627,727</u>
NONCASH TRANSACTIONS		
Transfer of the W. T. Young Library to the University of Kentucky	\$ -	\$ (44,542,002)
Transfer of capital equipment (to) from the University of Kentucky	\$ (158,634)	\$ 9,421
Trade in and disposal of capital equipment	\$ 12,974	\$ 8,463
Change in capital accounts payable	\$ 15,687	\$ (4,409)

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The University of Kentucky Athletic Association (the Association) is a not-for-profit Kentucky corporation, established to promote athletics and physical culture for students at the University of Kentucky (the University) and residents of the Commonwealth of Kentucky (the Commonwealth). The Association is considered to be an affiliate and component unit of the University because all Board members are related to the University as faculty, staff or alumni and/or are appointed by the President of the University, and certain officers of the Association are officers of the University.

Basis of Presentation

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

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
 - Nonexpendable* – Net assets subject to externally imposed stipulations that they be maintained permanently by the Association.
 - Expendable* – Net assets whose use by the Association is subject to externally imposed stipulations that can be fulfilled by actions of the Association pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net assets whose use by the Association is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation required by GASB Statement No. 35 is intended to provide a comprehensive, entity-wide perspective of the Association's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

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

Summary of Significant Accounting Policies

Accrual Basis. The financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. The Association reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35. BTAs 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 Association considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Cash and cash equivalents of the Association's endowment funds are included in noncurrent endowment investments.

Accounts Receivable. This classification consists of amounts due from sponsors for advertising rights and reimbursement of expenses made pursuant to contract agreements. Accounts receivable are recorded net of estimated uncollectible amounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. No allowance was deemed necessary for 2010 or 2009.

Inventories. Inventories are stated principally at the lower of average cost or market. Inventories primarily consist of sports equipment and supplies.

Pooled Endowment Funds. The Association's endowment investments are administered as part of the University's pooled endowment funds. All contributing endowments participate in the income and appreciation of the pool on a per unit basis commensurate with their contribution to the pool. New endowments purchase units in the pool at the current unit value which is calculated each month based on the fair value of the pool investments divided by the number of pool units outstanding. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

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

For the years ended June 30, 2010 and 2009, the University's endowment spending rule provided for annual distributions of 4.5 percent of the thirty-six month moving average market value of fund units. For the years ended June 30, 2010 and 2009 approximately \$7,600 and \$6,200, respectively, was transferred from endowment realized and unrealized gains to support current programs in accordance with the University's endowment spending rule. Additionally, for the years ended June 30, 2010 and 2009, the University assessed eligible endowment accounts with a management fee of 0.5 percent of total asset value.

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

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

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 and 5 – 20 years for equipment and vehicles.

Deferred Revenue. Deferred revenue consists of amounts received in advance of an event, primarily football ticket and football reserved parking sales relating to the upcoming season. Revenue is recognized in the period in which the event occurs.

Compensated Absences. The amount of vacation leave earned but not taken by University employees at June 30 is recorded as a liability owed to the University by the Association. Compensated absence liabilities are computed using the pay rates in effect at the statement of net assets date plus an additional amount for compensation-related payments such as social security and Medicare taxes, computed using rates in effect at that date.

Income Taxes. The Association is exempt from federal income tax under the Internal Revenue Code, as a 501(c)(3) organization.

Restricted Asset Spending Policy. The Association's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination of 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 Association 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 Association's expenses are from exchange transactions. Certain revenues relied upon for operations, such as gifts and investment income, are recorded as nonoperating 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 accrued expenses and other liability accounts.

2. DEPOSITS AND INVESTMENTS

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

	<u>2010</u>	<u>2009</u>
Cash on deposit with the University of Kentucky	\$ 24,929,560	\$ 19,264,450
Investment in University of Kentucky pooled endowment fund (quasi endowment)	<u>249,342</u>	<u>237,911</u>
Total	<u>\$ 25,178,902</u>	<u>\$ 19,502,361</u>
	<u>2010</u>	<u>2009</u>
Statement of Net Assets classification		
Cash and cash equivalents	\$ 24,929,560	\$ 19,264,450
Endowment investments	<u>249,342</u>	<u>237,911</u>
Total	<u>\$ 25,178,902</u>	<u>\$ 19,502,361</u>

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

Deposit and investment policies. The Association follows the deposit and investment policies established by the University of Kentucky's Board of Trustees. Such policies are developed to establish and maintain sound financial management practices for the investment and management of the Association's funds.

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

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

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

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

Deposit and investment risks. The Association'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 Association to experience a loss of principal.

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

- Cash on deposit with the University of Kentucky is governed by policy that minimizes risk in several ways. Deposits are governed by state law which requires full collateralization. Credit risk on repurchase agreements is mitigated by requiring the issuing financial institution's pledge of specific U.S. treasury or agency securities, held in the name of the University by the Federal Reserve Bank. Credit risk on repurchase agreements with the Commonwealth of Kentucky is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth.
- Endowment managers are permitted to use derivative instruments to limit credit risk. Additionally, endowment investments held by the University's fixed income managers are generally limited to holdings of high quality fixed income securities. These managers may invest a portion of the portfolio in other below-investment grade bonds, non-U.S. dollar denominated bonds, and emerging market bonds, provided the overall credit quality of the fixed income portfolios is not lower than A-.

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

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

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

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

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

- Cash on deposit with the University is not limited as to the maximum amount that may be invested in one issuer. However, all such investments in excess of Federal Depository Insurance are required to be fully collateralized by U.S. treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- The University's endowment fixed income managers are limited to a maximum investment in any one issuer of no more than five (5) percent of total investments excluding sovereign debt of governments belonging to the Organization for Economic Cooperation and Development and U.S. agencies.

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

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

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

- Cash on deposit with the University has limited exposure to interest rate risk due to the short term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Endowment managers are permitted to use derivative instruments to limit interest rate risk. Additionally, endowment investments held by the University's fixed income managers are limited to a duration that is within +/-25% of the duration of the Barclays Aggregate Bond Index.

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

The Association's exposure to foreign currency risk derives from certain endowment investments of the University's pooled endowment fund. The University's investment policy allows fixed-income managers to invest a portion of their portfolios in non-U.S. securities. Additionally, the investment policy allows various pooled fund managers to invest in accordance with the guidelines established in each individual fund's prospectus, which allows for investment in non-U.S. securities. The University's investments in the various pooled funds are denominated in U.S. dollars, with the exception of two private equity funds denominated in Euros. Endowment managers are permitted to use derivative instruments to limit foreign currency risk.

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

3. CAPITAL ASSETS, NET

Capital assets as of June 30, 2010 are summarized as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Equipment	\$ 4,795,606	\$ 614,980	\$ 189,673	\$ 5,220,913
Vehicles	561,459	21,168	-	582,627
	<u>5,357,065</u>	<u>636,148</u>	<u>189,673</u>	<u>5,803,540</u>
<u>Accumulated Depreciation</u>				
Equipment	3,137,399	473,484	172,199	3,438,684
Vehicles	365,142	81,852	-	446,994
	<u>3,502,541</u>	<u>555,336</u>	<u>172,199</u>	<u>3,885,678</u>
Net capital assets	<u>\$ 1,854,524</u>	<u>\$ 80,812</u>	<u>\$ 17,474</u>	<u>\$ 1,917,862</u>

Capital assets as of June 30, 2009 are summarized as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Land improvements	\$ 1,230,120		\$ 1,230,120	
Buildings	60,929,130		60,929,130	
Fixed equipment	3,357,841		3,357,841	
Equipment	5,001,404	\$ 320,448	\$ 526,246	\$ 4,795,606
Vehicles	552,264	65,679	56,484	561,459
Construction in process	214,692	-	214,692	-
	<u>71,285,451</u>	<u>386,127</u>	<u>66,314,513</u>	<u>5,357,065</u>
<u>Accumulated Depreciation</u>				
Land improvements	1,230,120	-	1,230,120	-
Buildings	16,699,180	-	16,699,180	-
Fixed equipment	3,260,481	-	3,260,481	-
Equipment	3,057,624	478,365	398,590	3,137,399
Vehicles	356,929	64,697	56,484	365,142
	<u>24,604,334</u>	<u>543,062</u>	<u>21,644,855</u>	<u>3,502,541</u>
Net capital assets	<u>\$ 46,681,117</u>	<u>\$ (156,935)</u>	<u>\$ 44,669,658</u>	<u>\$ 1,854,524</u>

Change in equipment depreciation includes the transfer of \$1,066 in accumulated depreciation for equipment transferred from the University.

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	2010	2009
Payable to vendors and contractors	\$ 1,991,700	\$ 2,072,042
Due to the University of Kentucky for accrued payroll and vacation	516,348	492,443
Total	<u>\$ 2,508,048</u>	<u>\$ 2,564,485</u>

5. LONG TERM LIABILITIES

Long-term liabilities as of June 30, 2010, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Deferred compensation	<u>\$ -</u>	<u>\$ 641,858</u>	<u>\$ 641,858</u>	<u>\$ -</u>	<u>\$ 641,858</u>

6. CONTINGENT LIABILITIES

The Association is responsible for annual debt service payments related to certain athletic facilities as follows:

- Commonwealth Football Stadium was expanded and renovated in 1999. Funding for this project was provided by the University, through a lease financing arrangement with the Commonwealth of Kentucky. Although the debt for this project is not reflected on the Association's financial statements, the Association is responsible for the annual lease payment on Commonwealth Stadium of approximately \$2.2 million.
- A project was completed in fiscal year 2007 to renovate and expand Memorial Coliseum. To provide part of the required funding for this project, the University issued \$7.2 million of its General Receipts Bonds in fiscal 2006. Although the debt for this project is not reflected on the Association's financial statements, the Association is responsible for the annual debt service payment on these bonds, which is approximately \$528,000.

7. INVESTMENT INCOME

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

	<u>2010</u>	<u>2009</u>
Interest and dividends earned on endowment investments	\$ 5,815	\$ 7,595
Realized and unrealized gains and losses on endowment investments	23,703	(71,259)
Interest on cash and non-endowment investments	<u>25,747</u>	<u>142,993</u>
Total	<u>\$ 55,265</u>	<u>\$ 79,329</u>

8. TRANSACTIONS WITH THE UNIVERSITY OF KENTUCKY

All salaries, wages and benefits reimbursements represent charges for University employees. Payments for the capital lease for Commonwealth Stadium and the debt service for Memorial Coliseum are grants to the University of Kentucky. For each of the years ended June 30, 2010 and 2009, payments of capital leases for Commonwealth Stadium were \$2,216,000 and \$2,213,000, respectively. Payments for debt service for Memorial Coliseum for the years ended June 30, 2010 and 2009 were \$528,000 and \$527,000, respectively.

9. THE UNIVERSITY OF KENTUCKY K FUND

The University of Kentucky K Fund is a restricted fund within the University that can be used at the discretion of the Board of Trustees of the University for specified purposes related only to intercollegiate athletic activities of the University. The K Fund's expenses for the year ended June 30, 2010 included grants to the Association of \$13,525,000 and to the University's unexpended plant funds of \$400,000. The K Fund's expenses for the year ended June 30, 2009 consisted entirely of grants to the Association of \$11,716,000. The Association's financial statements for both of these years reflect the grants received from the K Fund as part of the grants from the University for noncapital purposes.

10. RISK MANAGEMENT

The Association is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omission; and natural disasters. These risks are covered by the State Fire and Tornado Insurance Fund (the Fund), commercial insurance, extension of coverage by the University's participation in an insurance risk retention group, and self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and other named perils between \$250,000 and \$500,000 per occurrence. Losses in excess of \$500,000 are insured by commercial carriers up to \$500 million per occurrence, buildings at replacement cost and contents on an actual cash value basis. Claims against directors, officers and employees for wrongful acts (errors and omission) are insured through a risk retention group. There have been no significant reductions in insurance coverage from 2009 to 2010. Settlements have not exceeded insurance coverage during the past three years.

11. CURRENT ECONOMIC CONDITIONS

The current protracted economic decline continues to present not-for-profit organizations with difficult circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments, contributions, purchases of tickets to athletic events, and sport camp memberships. These conditions have made it difficult for many donors to continue to contribute to not-for-profit organizations and have caused many individuals to become more conservative in their spending. A significant decline in donation revenue, purchases of tickets to athletic events and sport camp memberships could have an adverse impact on the Association's future operating results. The financial statements have been prepared using values and information currently available to the Association.

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