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UNIVERSITY OF
KENTUCKY®

Athletic Association

2008 Financial Statements

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

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BKD LLP

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 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 year ended June 30, 2008, 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 audit. The financial statements of the Association as of and for the year ended June 30, 2007, were audited by other accountants whose report dated November 15, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2008 financial statements referred to above present fairly, in all material respects, the financial position of the Association as of June 30, 2008, and the changes in its financial position and its cash flows for the year 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 information and express no opinion on it.

BKD, LLP

September 29, 2008

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Management's Discussion and Analysis

The University of Kentucky Athletic Association's (the Association) Management 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, 2008 and 2007. 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 2007-2008 report a strong financial condition at June 30, 2008. Financial operations were in accordance with the revenue expectations and the approved budget plan.
- Total assets and liabilities were comparable to the previous year, at $69.9 million and $52.4 million, respectively, while net assets increased approximately $1.7 million, or 10.8%, to $17.4 million.
- Operating revenues increased approximately $8.4 million to $55.9 million, primarily due to an increase in ticket revenues for the men's basketball and football teams.
- Operating expenses increased approximately $4.6 million to $58.1 million, principally due to an increase in administrative and general expenses of $2.5 million and an increase in sports expenses of $2.0 million.
- Net nonoperating revenues decreased $2.1 million, primarily due to a decrease in transfers from the University for noncapital purposes and an increase 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 of the officers of the Association are officers of the University.

Condensed Financial Information

Statements of Net Assets

	2008	2007	2006
ASSETS			
Current assets	$ 19,685,313	$ 17,321,662	$ 16,092,316
Capital assets	46,681,117	48,026,822	49,378,034
Other noncurrent assets	3,485,461	3,526,620	3,486,953
Total assets	69,851,891	68,875,104	68,957,303
LIABILITIES			
Current liabilities	15,956,088	15,355,760	14,116,563
Noncurrent liabilities	36,450,000	37,770,000	39,035,000
Total liabilities	52,406,088	53,125,760	53,151,563
NET ASSETS			
Invested in capital assets, net of related debt	12,086,742	12,167,447	12,303,659
Restricted			
Expendable	367,213	407,427	358,401
Unrestricted	4,991,848	3,174,470	3,143,680
Total net assets	$ 17,445,803	$ 15,749,344	$ 15,805,740

Assets. As of June 30, 2008, the Association's total assets amounted to approximately $69.9 million. Capital assets, net of depreciation, represented the Association's largest asset, totaling approximately $46.7 million or 66.8% of total assets. Cash and cash equivalents totaling approximately $16.1 million, or 23.0% of total assets, were the Association's next largest asset.

Total assets increased approximately $977,000 or 1.4% primarily due to an increase in cash and cash equivalents of $2.4 million resulting principally from an increase in sports revenues, offset by a decrease in capital assets of $1.3 million caused by current year depreciation expense of $2.1 million, offset by net capital asset additions and disposals of $800,000.

Liabilities. At June 30, 2008, the Association's liabilities totaled approximately $52.4 million. Bonds payable for the W.T. Young Library represented approximately $37.8 million or 72.1% of total liabilities. Deferred revenue totaling approximately $12.1 million or 23.1% of total liabilities was primarily comprised of advance sales of football tickets and reserved parking.

Total liabilities decreased $720,000 during the year ended June 30, 2008. A decrease in long term liabilities of $1.3 million due to current year maturities of bonds was offset by an increase in accounts payable and accrued liabilities of $425,000 and an increase in deferred revenue of $132,000.

Net Assets. Net assets at June 30, 2008, totaled approximately $17.4 million, or 24.9% of total assets. Net assets invested in capital, net of related debt, totaled approximately $12.1 million or 69.3% of total net assets. Restricted net assets totaled $367,000 or 2.1% of total net assets. Unrestricted net assets accounted for approximately $5.0 million or 28.6% of total net assets.

Total net assets increased by approximately $1.7 million during the year ended June 30, 2008, driven by an increase of $1.8 million in unrestricted net assets caused by operating and nonoperating revenues in excess of operating expenses and transfers to the University.

2007 Versus 2006. During the year ended June 30, 2007:

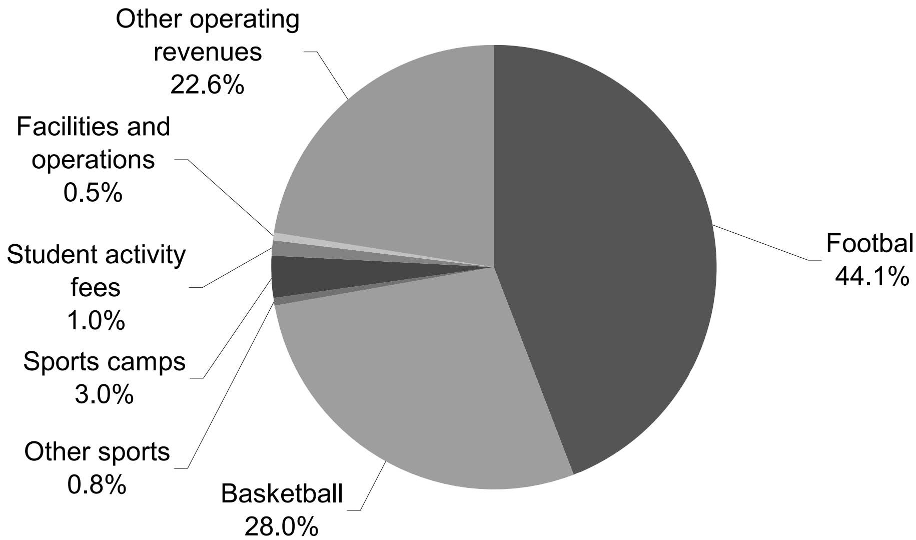
- Total assets decreased approximately $82,000 or 0.1%. A decrease in capital assets of $1.4 million, caused by current year depreciation expense and net additions and disposals, was offset by increases in cash and cash equivalents, accounts receivable and inventories.
- Total liabilities decreased $26,000 during the year ended June 30, 2007. An increase in deferred revenue of $2.8 million, related to football tickets for the 2007 season, was offset by decreases in accounts payable of $1.6 million and long term liabilities of $1.2 million.
- Total net assets decreased by approximately $56,000 during the year ended June 30, 2007.

Statements of Revenues, Expenses and Changes in Net Assets

	2008	2007	2006
OPERATING REVENUES			
Football	$ 24,683,861	$ 21,175,152	$ 18,974,943
Basketball	15,648,394	11,991,889	12,243,259
Other sports	427,442	446,365	365,964
Total sports	40,759,697	33,613,406	31,584,166
Sports camps	1,691,558	1,726,652	1,676,569
Student activity fees	569,136	530,673	634,271
Facilities and operations	264,124	684,415	288,636
Other operating revenue, primarily media rights and sponsorships	12,646,636	10,961,801	10,878,900
Total operating revenues	55,931,151	47,516,947	45,062,542
OPERATING EXPENSES			
Football	11,197,451	9,544,909	8,618,867
Basketball	8,423,872	8,496,624	6,561,266
Other sports	12,974,017	12,567,841	11,493,197
Total sports	32,595,340	30,609,374	26,673,330
Sports camps	1,671,588	1,677,652	1,627,117
Facilities and operations	7,642,062	7,229,543	5,670,853
Administrative and general	14,076,959	11,594,985	12,152,021
Depreciation	2,161,461	2,478,790	2,474,802
Total operating expenses	58,147,410	53,590,344	48,598,123
LOSS FROM OPERATIONS	(2,216,259)	(6,073,397)	(3,535,581)
NONOPERATING REVENUES (EXPENSES)			
Royalties/license fees	1,692,466	1,487,901	1,529,767
Gifts	-	-	2,166
Investment income	512,064	564,615	406,342
Grants from the University of Kentucky for noncapital purposes	8,161,828	9,442,206	7,706,743
Interest on capital asset-related debt	(1,898,052)	(1,951,527)	(2,002,263)
Net nonoperating revenues and expenses	8,468,306	9,543,195	7,642,755
Net income before other revenues, expenses, gains, or losses	6,252,047	3,469,798	4,107,174
Grants to the University of Kentucky for capital purposes	(4,506,196)	(3,491,412)	(5,317,541)
Other	(49,392)	(34,782)	(17,388)
Total other expenses	(4,555,588)	(3,526,194)	(5,334,929)
Total increase (decrease) in net assets	1,696,459	(56,396)	(1,227,755)
Net assets, beginning of year	15,749,344	15,805,740	17,033,495
Net assets, end of year	$ 17,445,803	$ 15,749,344	$ 15,805,740

Total operating revenues were approximately $55.9 million for the year ended June 30, 2008. The most significant sources of operating revenue for the Association were football (44.1%), basketball (28.0%), and other operating revenues, primarily media rights and sponsorships (22.6%). Operating revenues increased approximately $8.4 million primarily due to an increase in basketball revenues of $3.7 million or 30.5% and football revenues of $3.5 million or 16.6%. This increase in revenue was mainly caused by an increase in ticket revenue for men's basketball and football games. There was also an increase in other operating revenue of $1.7 million or 15.4%.

TOTAL OPERATING REVENUES

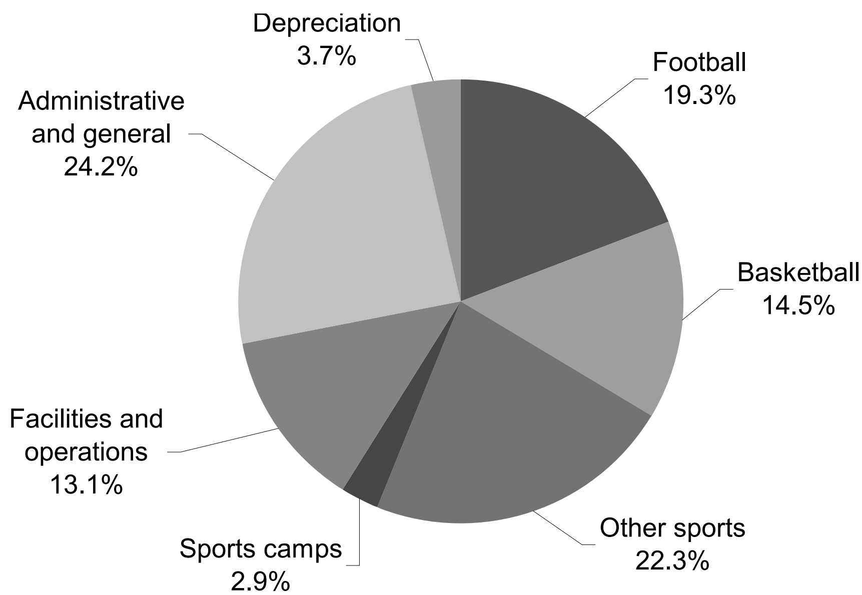


Operating expenses, including approximately $2.2 million of depreciation, totaled $58.1 million. Of this amount, approximately $32.6 million or 56.1% was used in direct support of sports programs and $14.1 million or 24.2% supported the Association's administrative operations.

Operating expenses increased approximately $4.6 million or 8.5%. This increase was primarily caused by an increase in administrative and general expenses of $2.5 million or 21.4% and an increase in sports related expenses of $2.0 million or 6.5%. Several factors affected operating expenses this year. Administrative and general expenses increased primarily in legal costs involved with settling a long-standing lawsuit from the renovation of Commonwealth Stadium and also in higher advertising costs. Sports operating expenses increased primarily because of an increase of $1.7 million in football expenses.

The Association's expenses for operating sports programs include scholarship expenses of approximately $8.2 million. These scholarships are funded by a transfer from the University of Kentucky K Fund.

TOTAL OPERATING EXPENSES



<u>2007 Versus 2006.</u> During the year ended June 30, 2007:

- Total operating revenues were approximately $47.5 million for the year ended June 30, 2007. The most significant sources of operating revenue for the Association were football (44.6%), basketball (25.2%), and other operating revenues, primarily media rights and sponsorships (23.2%). Operating revenues increased approximately $2.5 million primarily due to an increase in football revenues of $2.2 million or 11.6%. This increase in revenue was mainly caused by the football team participating in a post season bowl.

- Operating expenses increased approximately $5.0 million or 10.3%. This increase was primarily caused by an increase in sports expenses of $3.9 million or 14.8% and an increase in facilities and operations expenses of $1.6 million or 27.5%. Several factors affected operating expenses. Basketball and other sports expenses increased primarily in coaching salaries. Higher spending on other sports was built into the operating budget as part of a continuing effort to improve Olympic sports in order to be more competitive with benchmark institutions. Football expenses increased primarily in costs associated with participating in a post season bowl and in coaching salaries. Facility and operations expenses increased mainly due to non-capital expenses related to the expansion of Memorial Coliseum.

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,
- the Association's ability to meet obligations as they become due, and
- the Association's need for external financing.

	2008	2007	2006
CASH PROVIDED (USED) BY :			
Operating activities	$ 524,990	$ (2,953,016)	$ 1,035,078
Noncapital financing activities	9,863,360	10,938,713	9,246,831
Capital and related financing activities	(8,573,089)	(7,848,062)	(9,107,306)
Investing activities	553,223	524,950	392,759
Net increase in cash and cash equivalents	2,368,484	662,585	1,567,362
Cash and cash equivalents, beginning of year	13,724,368	13,061,783	11,494,421
Cash and cash equivalents, end of year	$ 16,092,852	$ 13,724,368	$ 13,061,783

The major source of funds included in operating activities is revenue from sports of approximately $40.9 million for the year ended June 30, 2008. The largest cash payments for operating activities were made to suppliers and for salaries and wages of approximately $34.9 million and $21.1 million, respectively. Cash provided by operating activities increased $3.5 million due to an increase of $5.0 million in sports revenues and an increase of $1.8 million in other receipts offset by an increase in payments to suppliers of $2.8 million and an increase of $525,000 in salaries and wages as discussed under the Statement of Revenues, Expenses and Changes in Net Assets.

During the year ended June 30, 2008, cash receipts in the noncapital financing activities group were generated by grants from the University for scholarships of approximately $8.2 million, and from royalties and license fees of approximately $1.7 million.

Cash used by capital and related financing activities is primarily expended to fund the construction and acquisition of capital assets, either through direct purchase or through principal and interest payments on debt.

During the year ended June 30, 2008, cash provided by investing activities reflects proceeds from sales and maturities of investments of approximately $3.6 million and interest and dividend income on investments of $548,000, net of cash used to purchase investments of $3.6 million.

2007 Versus 2006. Cash increased approximately $663,000 primarily due to cash flows from noncapital financing activities of $10.9 million, mainly from grants from the University, and from investing activities of $525,000. These were offset by a decrease in cash from operating activities of $3.0 million due to expenses exceeding revenues in this category and a decrease in cash from capital and related financing activities of $7.8 million primarily because of grants to the University for capital purposes and the payment of principal and interest on capital debt and leases.

Capital Asset and Debt Administration

Capital Assets. Capital assets, net of accumulated depreciation, totaled approximately $46.7 million at June 30, 2008, a net decrease of approximately $1.3 million over the prior year end. Significant changes to capital assets during FY 2007-2008 included:

Capital asset additions	$ 1,025,000
Capital asset disposals, net	$ (209,000)
Current year depreciation expense	$ (2,161,000)

Debt. At June 30, 2008, the Association had approximately $37.8 million in bonds payable related to the Commonwealth Library Project (W. T. Young Library) Bonds. Debt outstanding decreased approximately $1.3 million due to current year bond principal payments.

Factors Impacting Future Periods

There are no known facts and circumstances that will affect future financial results.

UNIVERSITY OF KENTUCKY ATHLETIC ASSOCIATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF NET ASSETS
JUNE 30, 2008 AND 2007

	2008	2007
ASSETS		
Current Assets		
Cash and cash equivalents	$ 16,092,852	$ 13,724,368
Accounts receivable	239,030	522,259
Inventories and other	3,353,431	3,075,035
Total current assets	19,685,313	17,321,662
Noncurrent Assets		
Endowment investments	309,170	350,426
Other long-term investments	3,176,291	3,176,194
Capital assets, net	46,681,117	48,026,822
Total noncurrent assets	50,166,578	51,553,442
Total assets	69,851,891	68,875,104
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	2,422,025	1,997,359
Deferred revenue	12,074,783	11,942,862
Due to the University of Kentucky	139,280	150,539
Long term liabilities - current portion	1,320,000	1,265,000
Total current liabilities	15,956,088	15,355,760
Noncurrent Liabilities		
Long term liabilities	36,450,000	37,770,000
Total noncurrent liabilities	36,450,000	37,770,000
Total liabilities	52,406,088	53,125,760
NET ASSETS		
Invested in capital assets, net of related debt	12,086,742	12,167,447
Restricted expendable	367,213	407,427
Unrestricted	4,991,848	3,174,470
Total net assets	$ 17,445,803	$ 15,749,344

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, 2008 AND 2007

	2008	2007
OPERATING REVENUES		
Sports:		
Football	$ 24,683,861	$ 21,175,152
Basketball	15,648,394	11,991,889
Other sports	427,442	446,365
Total sports	40,759,697	33,613,406
Sport camps	1,691,558	1,726,652
Student activity fees	569,136	530,673
Facilities and operations	264,124	684,415
Other operating revenues, primarily media rights and sponsorships	12,646,636	10,961,801
Total operating revenues	55,931,151	47,516,947
OPERATING EXPENSES		
Sports:		
Football	11,197,451	9,544,909
Basketball	8,423,872	8,496,624
Other sports	12,974,017	12,567,841
Total sports	32,595,340	30,609,374
Sport camps	1,671,588	1,677,652
Facilities and operations	7,642,062	7,229,543
Administrative and general	14,076,959	11,594,985
Depreciation	2,161,461	2,478,790
Total operating expenses	58,147,410	53,590,344
Net income (loss) from operations	(2,216,259)	(6,073,397)
NONOPERATING REVENUES (EXPENSES)		
Royalties/license fees	1,692,466	1,487,901
Investment income	512,064	564,615
Grants (to) from the University of Kentucky for noncapital purposes	8,161,828	9,442,206
Interest on capital asset-related debt	(1,898,052)	(1,951,527)
Net nonoperating revenues (expenses)	8,468,306	9,543,195
Net income (loss) before other revenues, expenses, gains, or losses	6,252,047	3,469,798
Grants (to) from the University of Kentucky for capital purposes	(4,506,196)	(3,491,412)
Other	(49,392)	(34,782)
Total other revenues (expenses)	(4,555,588)	(3,526,194)
Increase (decrease) in net assets	1,696,459	(56,396)
NET ASSETS, beginning of year	15,749,344	15,805,740
NET ASSETS, end of year	$ 17,445,803	$ 15,749,344

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, 2008 AND 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Revenues from sports	$ 40,899,619	$ 35,882,280
Payments to vendors and contractors	(34,873,563)	(32,084,899)
Salaries, wages and benefits	(21,148,514)	(20,623,357)
Other receipts (payments)	15,647,448	13,872,960
Net cash provided (used) by operating activities	524,990	(2,953,016)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Royalties/license fees	1,692,466	1,487,901
Grants (to) from the University of Kentucky	8,170,894	9,450,812
Net cash provided (used) by noncapital financing activities	9,863,360	10,938,713
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	(4,526,521)	(3,510,568)
Purchases of capital assets	(874,450)	(1,162,361)
Principal paid on capital debt and leases	(1,265,000)	(1,215,000)
Interest paid on capital debt and leases	(1,907,118)	(1,960,133)
Net cash provided (used) by capital and related financing activities	(8,573,089)	(7,848,062)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	3,616,029	2,708,801
Interest and dividends on investments	547,792	522,613
Purchase of investments	(3,610,598)	(2,706,464)
Net cash provided (used) by investing activities	553,223	524,950
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,368,484	662,585
CASH AND CASH EQUIVALENTS, beginning of year	13,724,368	13,061,783
CASH AND CASH EQUIVALENTS, end of year	$ 16,092,852	$ 13,724,368
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	$ (2,216,259)	$ (6,073,397)
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Depreciation expense	2,161,461	2,478,790
Change in assets and liabilities:		
Accounts receivable, net	283,229	(377,209)
Inventories and other	(278,396)	(189,552)
Accounts payable and accrued liabilities	443,034	(1,572,553)
Deferred revenue	131,921	2,780,905
Net cash provided (used) by operating activities	$ 524,990	$ (2,953,016)

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 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 of the 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:

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

- <u>Restricted:</u>
  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.

- <u>Unrestricted:</u> 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

<u>Accrual Basis.</u> 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. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

<u>Cash and Cash Equivalents</u>. 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 2008 or 2007.

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

Pooled Endowment Funds. The Association's endowment investments are administered as part of the University's 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 annual distributions of 4.5 percent of the three-year moving average market value of fund units. For the years ended June 30, 2008 and 2007 approximately $3,900 and $3,800, 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 $100,000 at June 30, 2008. Additionally, the University assesses eligible endowment accounts with a management fee of 0.5 percent of total asset value to support fundraising and endowment administration.

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 fall 2008 season. Revenue is recognized in the period in which the event occurs.

Compensated Absences. The amount of vacation leave earned but not taken by employees at June 30, 2008 is recorded as a liability 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 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 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, 2008 and 2007 is as follows:

	2008	2007
Cash on deposit with the University of Kentucky	$ 16,092,852	$ 13,724,368
Investment in University of Kentucky pooled endowment fund (quasi endowment)	309,170	350,426
Debt service reserve funds investments - Repurchase agreements backed by U.S. treasury and agency bonds	3,176,291	3,176,194
Total	$ 19,578,313	$ 17,250,988

	2008	2007
Statement of Net Assets classification		
Cash and cash equivalents	$ 16,092,852	$ 13,724,368
Endowment investments	309,170	350,426
Other long-term investments	3,176,291	3,176,194
Total	$ 19,578,313	$ 17,250,988

At June 30, 2008, the University's pooled endowment fund consists of pooled equity funds (66.0%), private equity funds (1.7%), pooled real estate funds (9.0%), government agency fixed income funds (5.8%), corporate fixed income funds (5.9%), pooled fixed income funds (10.8%) and cash equivalents (0.8%).

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 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,
- Endowment investments in the University's pooled endowment fund, and
- Debt service reserve fund investments required by the bond trust indenture for the library bonds and held by the bond trustee.

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.

The investment of the debt service reserve fund is governed by the library bond's trust indenture.

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 with local banks 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 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-.
- Debt service reserve funds may be invested in direct obligations of the U.S. and securities fully guaranteed by the U.S.; direct obligations of certain U.S. agencies; direct obligations of states or subdivisions rated Aa or better by Moody's Investors Service; commercial paper and certificates of deposit rated P-1 or better by Moody's; certificates of deposit fully secured by depository insurance; and repurchase agreements collateralized by direct U.S. obligations or direct obligations of certain U.S. agencies.

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 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. 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.

- Investment securities held in the bond debt service reserve fund are held by the bond trustee in a specific trust account for the benefit of the University, Association and bondholders.

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 investment managers are limited to a maximum investment in any one issuer of no more than 5% of total investments.
- There is no specific limit on the maximum amount of investment securities held in the bond debt service reserve fund that may be invested in any one issuer. However, in general, such investments are limited to bonds fully secured by the U.S. treasury or agency securities.

At June 30, 2008, the Association had no underlying investments in any one issuer, other than U.S. treasury or agency securities in the debt service reserve fund, which represent more than 5% 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 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 investments held by the University's fixed income managers are limited to a duration that is within +/-25% of the duration of the Lehman Aggregate Bond Index.
- Funds held in the bond debt service reserve fund which are invested in repurchase agreements, as are the Associations', are required to have a term of 30 days or less and the collateral securities are required to be revalued no less frequently than weekly.

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 Association's exposure to foreign currency risk derives from certain limited endowment investments of the University's pooled endowment fund, 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.

3. CAPITAL ASSETS, NET

Capital assets as of June 30, 2008 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	3,265,297	$ 92,544		3,357,841
Equipment	4,631,024	696,636	$ 326,256	5,001,404
Vehicles	487,768	80,192	15,696	552,264
Construction in process	213,586	155,517	154,411	214,692
	70,756,925	1,024,889	496,363	71,285,451
Accumulated Depreciation				
Land improvements	1,230,120			1,230,120
Buildings	15,168,738	1,530,442		16,699,180
Fixed equipment	3,189,299	71,182		3,260,481
Equipment	2,821,102	508,056	271,534	3,057,624
Vehicles	320,844	51,781	15,696	356,929
	22,730,103	2,161,461	287,230	24,604,334
Net capital assets	$ 48,026,822	$ (1,136,572)	$ 209,133	$ 46,681,117

Capital assets as of June 30, 2007 are summarized as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Land improvements	$ 1,230,120			$ 1,230,120
Buildings	60,647,480	$ 281,650		60,929,130
Fixed equipment	3,254,408	10,889		3,265,297
Equipment	4,151,477	632,628	$ 153,081	4,631,024
Vehicles	487,768	-	-	487,768
Construction in process	-	213,586	-	213,586
	69,771,253	1,138,753	153,081	70,756,925
Accumulated Depreciation				
Land improvements	1,107,108	123,012		1,230,120
Buildings	13,645,337	1,523,401		15,168,738
Fixed equipment	2,863,314	325,985		3,189,299
Equipment	2,510,918	452,090	141,906	2,821,102
Vehicles	266,542	54,302	-	320,844
	20,393,219	2,478,790	141,906	22,730,103
Net capital assets	$ 49,378,034	$ (1,340,037)	$ 11,175	$ 48,026,822

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2008 and 2007, are as follows:

	2008	2007
Payable to vendors and contractors	$ 1,438,557	$ 1,147,780
Accrued expenses, primarily vacation leave	670,148	527,193
Accrued interest payable	313,320	322,386
	$ 2,422,025	$ 1,997,359

5. LONG TERM LIABILITIES

Long-term liabilities as of June 30, 2008, are summarized as follows:

	Beginning Balance	Payments	Ending Balance	Current Portion	Noncurrent Portion
Library bonds	$ 39,035,000	$ 1,265,000	$ 37,770,000	$ 1,320,000	$ 36,450,000

Long-term liabilities as of June 30, 2007, are summarized as follows:

	Beginning Balance	Payments	Ending Balance	Current Portion	Noncurrent Portion
Library bonds	$ 40,250,000	$ 1,215,000	$ 39,035,000	$ 1,265,000	$ 37,770,000

Principal maturities and interest on bonds for the next five years and in subsequent five-year periods as of June 30, 2008 are as follows (in thousands):

	Principal	Interest	Total
2009	$ 1,320	$ 1,851	$ 3,171
2010	1,385	1,788	3,173
2011	1,455	1,717	3,172
2012	1,530	1,642	3,172
2013	1,610	1,564	3,174
2014-2018	9,370	6,493	15,863
2019-2023	12,030	3,831	15,861
2024-2025	9,070	541	9,611
Total	$ 37,770	$ 19,427	$ 57,197

With regard to the library bonds denoted above, the Association has agreed to fund the debt service on these bonds, issued by the Lexington-Fayette Urban County Government (LFUCG), for the construction of the W. T. Young Library on the campus of the University. The University of Kentucky Alumni Association had the responsibility for construction of the library building and the bonds were issued in the Alumni Association's name. The library building was completed during 1998 and the University has the right to full utilization of the building. When the bonds are fully paid, legal title to the library will be transferred to the University. Payment of the bonds is guaranteed by the Kentucky Medical Services Foundation, Inc., a related organization of the University. The bonds are further collateralized by the related land and library building. The bonds were issued at a total amount of $43,420,000 with interest rates of 4.0% to 5.0% with 2024 as the year of maturity and the requirement of a debt service reserve of $3,176,000.

As the Athletic Association has the primary responsibility for payment of the bonds, both the library building and bonds are recorded on the financial statements of the Association.

The bonds are callable at various rates ranging from 100% to 102% of face value after ten years from issuance.

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 $526,000.

7. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2008 and 2007 are as follows:

	2008	2007
Interest and dividends earned on endowment investments	$ 9,099	$ 8,137
Realized and unrealized gains and losses on endowment investments	(35,728)	41,999
Interest on cash and non-endowment investments	538,693	514,474
Realized and unrealized gains and losses on non-endowment investments	-	5
Total	$ 512,064	$ 564,615

8. TRANSACTIONS WITH THE UNIVERSITY OF KENTUCKY

All salaries, wages and benefits 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, 2008 and 2007, payments of capital leases for Commonwealth Stadium were $2,215,000. Payments for debt service for Memorial Coliseum for the years ended June 30, 2008 and 2007 were $526,000 and $516,000, 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, 2008 include grants to the Association of $9,596,000 and to the University's endowment funds of $4,000,000. The K Fund's expenses for the year ended June 30, 2007 consisted entirely of grants to the Association of $8,833,000. 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 2007 to 2008. Settlements have not exceeded insurance coverage during the past three years.