2012 Financial Statements

Athletic Association

UNIVERSITY OF
KENTUCKY®

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, 2012 and 2011, 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 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 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, 2012 and 2011, 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.

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

Our audit was performed for the purpose of forming an opinion on the basic financial statements as a whole. The board of directors listing as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

BKD, LLP

September 28, 2012

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, 2012 and 2011. 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 2011-2012 report a solid financial condition at June 30, 2012. Financial operations were in accordance with the revenue expectations and the approved budget plan.
- Total assets decreased $794,755 or 2.7%. The most significant component of the fluctuation was a $671,413 decrease in cash and cash equivalents.
- Total liabilities increased $6,806,725 or 40.4%. Long term liabilities increased $8,952,843, offset by a decrease in deferred revenue of $2,152,615.
- Net assets decreased $7,601,480 or 62.6% caused by operating expenses and grants to the University in excess of operating and nonoperating revenues.
- Operating revenues increased $2,780,652 to $69,307,234.
- Operating expenses increased $4,996,684 to $71,372,415.
- Nonoperating expenses, net, increased $4,103,225, primarily due to a $3,424,297 increase in grants to the University for capital purposes and a $753,835 decrease in grants from the University for noncapital 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

	2012	2011	2010
ASSETS			
Current assets	$ 26,146,050	$ 26,909,396	$ 28,822,817
Capital assets	1,804,082	1,810,659	1,917,862
Other noncurrent assets	264,677	289,509	249,342
Total assets	28,214,809	29,009,564	30,990,021
LIABILITIES			
Current liabilities	16,193,674	15,994,940	16,923,615
Noncurrent liabilities	7,480,290	872,299	641,858
Total liabilities	23,673,964	16,867,239	17,565,473
NET ASSETS			
Invested in capital assets, net of related debt	1,804,082	1,810,659	1,917,862
Restricted			
Expendable	325,556	337,791	305,927
Unrestricted	2,411,207	9,993,875	11,200,759
Total net assets	$ 4,540,845	$ 12,142,325	$ 13,424,548

Assets. As of June 30, 2012, the Association's assets totaled $28,214,809. Cash and cash equivalents represented the Association's largest asset, totaling $22,106,774 or 78.4% of total assets. Inventories and other assets totaled $3,652,573 or 12.9%.

Total assets decreased $794,755 or 2.7% primarily due to a $671,413 decrease in cash and cash equivalents resulting from operating expenses and grants to the University exceeding operating and nonoperating revenues.

Liabilities. At June 30, 2012, the Association's liabilities totaled $23,673,964. Long term liabilities for an internal loan and coach longevity and retention bonuses were $9,825,142 or 41.5% of total liabilities. Deferred revenue, primarily comprised of advance sales of football tickets and reserved parking, totaled $11,644,443 and represented 49.2% of total liabilities.

Total liabilities increased $6,806,725 during the year ended June 30, 2012. Long term liabilities increased $8,952,843. The University provided an internal loan of $6,900,000 for additional funding of the track and field facility renovation. The liability for coach longevity and retention bonuses increased $2,052,843 mainly because of a contract amendment for the men's basketball head coach. There was an offsetting decrease in deferred revenue of $2,152,615 due to lower advance sales of football season tickets.

Net Assets. Net assets at June 30, 2012, totaled $4,540,845, or 16.1% of total assets. Invested in capital assets, net of related debt, totaled $1,804,082 or 39.7% of total net assets. Restricted net assets totaled $325,556 or 7.2% of total net assets. Unrestricted net assets accounted for $2,411,207 or 53.1% of total net assets.

Total net assets decreased $7,601,480 during the year ended June 30, 2012, primarily because of a decrease of $7,582,668 in unrestricted net assets caused by operating expenses and grants to the University in excess of operating and nonoperating revenues.

2011 Versus 2010. During the year ended June 30, 2011:

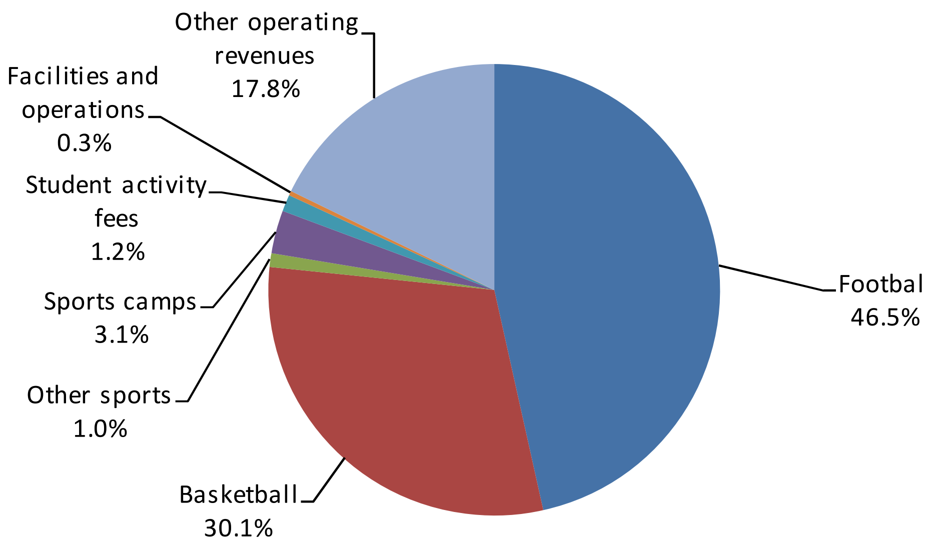
- Total assets decreased $1,980,457 or 6.4% primarily due to a $2,151,373 decrease in cash and cash equivalents resulting from operating expenses and grants to the University exceeding operating and nonoperating revenues.
- Total liabilities decreased $698,234. Deferred revenue decreased $503,896 due to lower advance sales of football tickets and reserved parking caused by a delay in offering student tickets for sale and fewer season ticket sales. Long term liabilities increased $230,441 due to an increase in the liability for coach longevity and retention bonuses due to a contract amendment for the men's basketball head coach.
- Total net assets decreased $1,282,223, primarily because of a decrease of $1,206,884 in unrestricted net assets caused by operating expenses and grants to the University in excess of operating and nonoperating revenues.

Statements of Revenues, Expenses and Changes in Net Assets

	2012	2011	2010
OPERATING REVENUES			
Football	$ 32,207,392	$ 33,130,188	$ 30,908,321
Basketball	20,842,008	17,937,889	17,440,345
Other sports	667,822	540,130	558,167
Total sports	53,717,222	51,608,207	48,906,833
Sports camps	2,142,206	1,975,339	1,689,513
Student activity fees	827,172	819,124	738,194
Facilities and operations	306,015	182,307	226,128
Other operating revenue, primarily media rights and sponsorships	12,314,619	11,941,605	12,091,660
Total operating revenues	69,307,234	66,526,582	63,652,328
OPERATING EXPENSES			
Football	12,933,808	13,852,365	13,354,165
Basketball	14,159,218	11,516,513	11,166,116
Other sports	17,446,845	15,630,767	14,366,104
Total sports	44,539,871	40,999,645	38,886,385
Sports camps	2,110,705	1,930,336	1,650,044
Facilities and operations	8,834,876	8,155,431	8,253,110
Administrative and general	15,401,276	14,756,844	18,205,416
Depreciation	485,687	533,475	555,336
Total operating expenses	71,372,415	66,375,731	67,550,291
NET INCOME (LOSS) FROM OPERATIONS	(2,065,181)	150,851	(3,897,963)
NONOPERATING REVENUES (EXPENSES)			
Royalties/license fees	2,317,952	2,133,534	1,487,572
Investment income	12,331	71,162	55,265
Grants from the University of Kentucky for noncapital purposes	10,531,737	11,285,572	9,548,068
Net nonoperating revenues and expenses	12,862,020	13,490,268	11,090,905
Net income before other revenues, expenses, gains, or losses	10,796,839	13,641,119	7,192,942
Capital gifts and grants	1,078	30,000	-
Grants to the University of Kentucky for capital purposes	(18,450,159)	(15,025,862)	(3,511,737)
Other	50,762	72,520	(12,974)
Total other expenses (net)	(18,398,319)	(14,923,342)	(3,524,711)
Total increase (decrease) in net assets	(7,601,480)	(1,282,223)	3,668,231
Net assets, beginning of year	12,142,325	13,424,548	9,756,317
Net assets, end of year	$ 4,540,845	$ 12,142,325	$ 13,424,548

2012. Total operating revenues were $69,307,234 for the year ended June 30, 2012. The most significant sources of operating revenue for the Association were football (46.5%), basketball (30.1%), and other operating revenues, primarily media rights and sponsorships (17.8%). Operating revenues increased $2,780,652 primarily due to increases in basketball revenue of $2,904,119 caused by increased ticket revenue as the result of more home games this year.

TOTAL OPERATING REVENUES

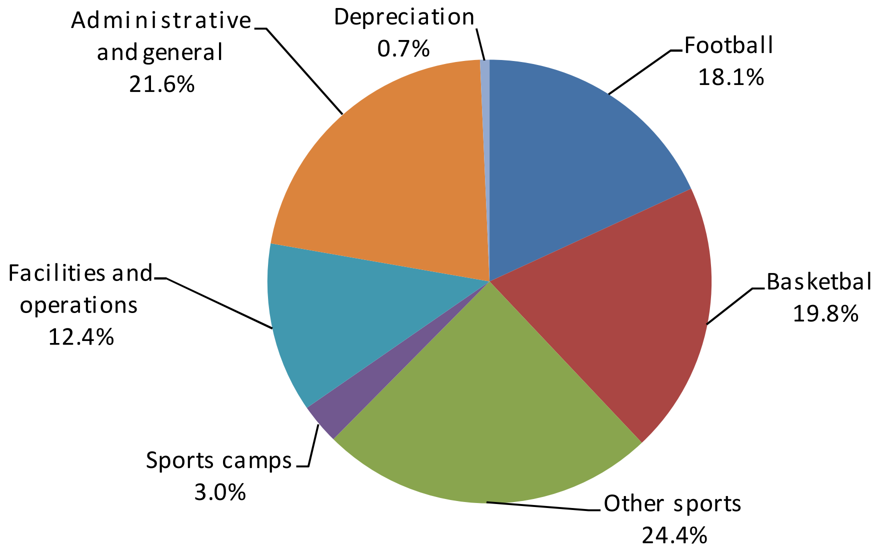


Operating expenses, including $485,687 of depreciation, totaled $71,372,415. Of this amount, $44,539,871 or 62.4% was used in direct support of sports programs and $15,401,276 or 21.6% supported the Association's administrative operations.

Operating expenses increased $4,996,684 or 7.5% primarily caused by increases in sports related expenses of $3,540,226 or 8.6%, facilities and operations expenses of $679,445 or 8.3% and administrative and general expenses of $644,432 or 4.4%. Sports related expenses increased mainly due to increased coaches' salaries caused by contractual bonus increases. Facilities and operations expenses increased primarily due to additional routine maintenance on buildings. Administrative and general expenses increased mainly due to increases in salaries, scholarships for trainers and tutors, and official guest expenses.

The Association's expenses for operating sports programs include scholarship expenses of $10,280,502. These scholarships are funded by a transfer from the University of Kentucky K Fund (the K Fund).

TOTAL OPERATING EXPENSES



__2011 Versus 2010.__ During the year ended June 30, 2011:

- Total operating revenues were $66,526,582. The most significant sources of operating revenue for the Association were football (49.8%), basketball (27.0%), and other operating revenues, primarily media rights and sponsorships (18.0%). Operating revenues increased $2,874,254 primarily due to increases in football revenue of $2,221,867 caused by increased ticket and parking passes revenue and additional funds provided by television rights as negotiated by the SEC.

- Operating expenses decreased $1,174,560 or 1.7% primarily caused by decreases in administrative and general expenses of $3,448,572 or 18.9%, offset by an increase in sports related expenses of $2,113,260 or 5.4%. Administrative and general expenses decreased primarily due to the settlement last year of a lawsuit with the former men's basketball head coach. Sports related expenses increased mainly due to increased coaches' salaries caused by contractual increases.

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.

	2012	2011	2010
CASH PROVIDED (USED) BY :			
Operating activities	$ (1,568,695)	$ (224,158)	$ (1,273,955)
Noncapital financing activities	12,849,689	13,419,106	11,035,640
Capital and related financing activities	(11,989,570)	(15,377,315)	(4,140,409)
Investing activities	37,163	30,994	43,834
Net increase in cash and cash equivalents	(671,413)	(2,151,373)	5,665,110
Cash and cash equivalents, beginning of year	22,778,187	24,929,560	19,264,450
Cash and cash equivalents, end of year	$22,106,774	$22,778,187	$24,929,560

2012. The major source of funds included in operating activities is revenue from sports of $51,713,920 for the year ended June 30, 2012. The largest cash payments for operating activities were made to suppliers and for reimbursements of salaries and wages of $38,408,321 and $30,257,290, respectively. Cash used by operating activities increased $1,344,537 due to increases of $1,650,910 in payments to suppliers and $1,142,434 in reimbursements of salaries and wages, offset by increases of sports revenues of $869,620 and other receipts of $579,187.

During the year ended June 30, 2012, cash receipts in the noncapital financing activities group were generated mainly by grants from the K Fund of $10,280,502 for athletic scholarships and $5,489,458 for student athlete support services, offset by transfers of $5,238,223 to the University, primarily in support of non-athletic scholarships. In addition, royalties and license fees provided cash of $2,317,952.

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 and the direct purchase of capital assets, offset by proceeds from an internal loan from the University to be used for capital purposes.

During the year ended June 30, 2012, cash provided by investing activities reflects proceeds from sales and maturities of investments of $130,678 and interest and dividend income on investments of $18,730, net of cash used to purchase investments of $112,245.

2011 Versus 2010. Cash decreased $2,151,373 primarily due to cash used by capital and related financing activities of $15,377,315 and operating activities of $224,158, offset by cash provided by noncapital financing activities of $13,419,106 and investing activities of $30,994.

Capital Asset and Debt Administration

Capital Assets. Capital assets, net of accumulated depreciation, of $1,804,082 at June 30, 2012, were comparable to the prior year end. Significant changes to capital assets during FY 2011-2012 included:

Capital asset additions	$	506,803
Capital asset disposals, net	$	(27,693)
Current year depreciation expense	$	(485,687)

Debt. As of June 30, 2012, the Association had a $6,900,000 loan from the University of Kentucky.

Factors Impacting Future Periods

In February 2012, the Board of Directors authorized the dissolution of the Association effective June 30, 2012. The assets of the Association will be transferred to the University in accordance with the Articles of Dissolution on July 1, 2012.

UNIVERSITY OF KENTUCKY ATHLETIC ASSOCIATION
A COMPONENT UNIT OF THE UNIVERSITY OF KENTUCKY
STATEMENTS OF NET ASSETS
JUNE 30, 2012 AND 2011

	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents	$ 22,106,774	$ 22,778,187
Accounts receivable	386,703	305,943
Inventories and other assets	3,652,573	3,825,266
Total current assets	26,146,050	26,909,396
Noncurrent Assets		
Endowment investments	264,677	289,509
Capital assets, net	1,804,082	1,810,659
Total noncurrent assets	2,068,759	2,100,168
Total assets	28,214,809	29,009,564
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	2,109,028	2,091,931
Deferred revenue	11,644,443	13,797,058
Due to the University of Kentucky	95,351	105,951
Long term liabilities - current portion	2,344,852	-
Total current liabilities	16,193,674	15,994,940
Noncurrent Liabilities		
Long term liabilities	7,480,290	872,299
Total noncurrent liabilities	7,480,290	872,299
Total liabilities	23,673,964	16,867,239
NET ASSETS		
Invested in capital assets, net of related debt	1,804,082	1,810,659
Restricted expendable	325,556	337,791
Unrestricted	2,411,207	9,993,875
Total net assets	$ 4,540,845	$ 12,142,325

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, 2012 AND 2011

	2012	2011
OPERATING REVENUES		
Sports:		
Football	$ 32,207,392	$ 33,130,188
Basketball	20,842,008	17,937,889
Other sports	667,822	540,130
Total sports	53,717,222	51,608,207
Sport camps	2,142,206	1,975,339
Student activity fees	827,172	819,124
Facilities and operations	306,015	182,307
Other operating revenues, primarily media rights and sponsorships	12,314,619	11,941,605
Total operating revenues	69,307,234	66,526,582
OPERATING EXPENSES		
Sports:		
Football	12,933,808	13,852,365
Basketball	14,159,218	11,516,513
Other sports	17,446,845	15,630,767
Total sports	44,539,871	40,999,645
Sport camps	2,110,705	1,930,336
Facilities and operations	8,834,876	8,155,431
Administrative and general	15,401,276	14,756,844
Depreciation	485,687	533,475
Total operating expenses	71,372,415	66,375,731
Net income (loss) from operations	(2,065,181)	150,851
NONOPERATING REVENUES (EXPENSES)		
Royalties/license fees	2,317,952	2,133,534
Investment income	12,331	71,162
Grants (to) from the University of Kentucky for noncapital purposes	10,531,737	11,285,572
Net nonoperating revenues (expenses)	12,862,020	13,490,268
Net income (loss) before other revenues, expenses, gains, or losses	10,796,839	13,641,119
Capital grants and gifts	1,078	30,000
Grants (to) from the University of Kentucky for capital purposes	(18,450,159)	(15,025,862)
Other	50,762	72,520
Total other revenues (expenses)	(18,398,319)	(14,923,342)
Increase (decrease) in net assets	(7,601,480)	(1,282,223)
NET ASSETS, beginning of year	12,142,325	13,424,548
NET ASSETS, end of year	$ 4,540,845	$ 12,142,325

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, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Revenues from sports	$ 51,713,920	$ 50,844,300
Payments to vendors and contractors	(38,408,321)	(36,757,411)
Salaries, wages and benefits reimbursements to the University of Kentucky	(30,257,290)	(29,114,856)
Other receipts (payments)	15,382,996	14,803,809
Net cash provided (used) by operating activities	(1,568,695)	(224,158)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Royalties/license fees	2,317,952	2,133,534
Grants (to) from the University of Kentucky	10,531,737	11,285,572
Net cash provided (used) by noncapital financing activities	12,849,689	13,419,106
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Grants (to) from the University of Kentucky for capital purposes	(18,460,759)	(15,034,524)
Purchases of capital assets	(428,811)	(342,791)
Loan from the University of Kentucky for capital purposes	6,900,000	-
Net cash provided (used) by capital and related financing activities	(11,989,570)	(15,377,315)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	130,678	249,365
Interest and dividends on investments	18,730	30,995
Purchase of investments	(112,245)	(249,366)
Net cash provided (used) by investing activities	37,163	30,994
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(671,413)	(2,151,373)
CASH AND CASH EQUIVALENTS, beginning of year	22,778,187	24,929,560
CASH AND CASH EQUIVALENTS, end of year	$ 22,106,774	$ 22,778,187
Reconciliation of net income (loss) from operations to net cash provided (used) by operating activities:		
Net income (loss) from operations	$ (2,065,181)	$ 150,851
Adjustments to reconcile net income (loss) from operations to net cash provided (used) by operating activities:		
Depreciation expense	485,687	533,475
Change in assets and liabilities:		
Accounts receivable, net	(80,760)	10,945
Inventories and other assets	172,693	(248,897)
Accounts payable and accrued liabilities	18,638	(397,077)
Deferred revenue	(2,152,615)	(503,896)
Long term liabilities	2,052,843	230,441
Net cash provided (used) by operating activities	$ (1,568,695)	$ (224,158)
NONCASH TRANSACTIONS		
Transfer of capital equipment (to) from the University of Kentucky	$ (129,597)	$ (26,540)
Trade in and disposal of capital equipment	$ 50,853	$ (25,437)
Capital asset additions in accounts payable	$ -	$ 1,541

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.

As discussed in note 12, the Association is being dissolved with all remaining assets being transferred to the University effective July 1, 2012. All activities of the Association will now be performed as a division within 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.

During the year ended June 30, 2012, the Association adopted Statement of Governmental Accounting Standards Board (GASB) No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which supersedes GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that statement for business-type activities to apply post-November 30, 1989, FASB statements and interpretations that do not conflict with or contradict GASB pronouncements. GASB No. 62 has been applied retrospectively and had no impact on the Association's net assets, changes in net assets or financial reporting disclosures.

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. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

Cash and Cash Equivalents. The 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 2012 or 2011.

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 Prudent Management of Institutional Funds Act ("UPMIFA"), as adopted by the Commonwealth of Kentucky in July 2010, the University employs a total return method for establishing investment objectives and spending policies designed to achieve financial equilibrium for endowment funds over the long-term.

The University utilizes a spending policy designed to smooth spending distributions and protect endowed programs from market volatility by calculating distributions based on a percentage of the average market value of the endowment over a specified period of time. The University has made expenditure decisions in accordance with prevailing UPMIFA statute and donor gift agreements. UPMIFA allows institutions to appropriate for expenditure so much of an endowment fund as the institution deems is prudent based on a review of various factors set forth in the Act, subject to terms set forth in a gift agreement.

For the year ended June 30, 2012 the University's endowment spending rule provided for annual distributions of 4.25 percent of the sixty month moving average market value of fund units. For the year ended June 30, 2011, the University's endowment spending rule provided for annual distributions of 4.375 percent of the sixty month moving average market value of fund units. The amount available for spending in accordance with the University's endowment spending policy was $6,734 and $7,128 for the years ended June 30, 2012 and 2011, respectively. Additionally, for the year ended June 30, 2012, the University assessed eligible endowment accounts with a management fee of 0.25 percent of total asset value. For the year ended June 30, 2011, the University assessed eligible endowment accounts with a management fee of 0.375 percent of total asset value.

The Investment Committee of the University's Board of Trustees has approved a spending rate distribution of 4.25 percent of a sixty month moving average market value of fund units for the year ended June 30, 2013. Additionally, the Investment Committee has approved a management fee of 0.25 percent for the year ended June 30, 2013.

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, 2012 and 2011 is as follows:

	2012	2011
Cash on deposit with the University of Kentucky	$ 22,106,774	$ 22,778,187
Investment in University of Kentucky pooled endowment fund (quasi endowment)	264,677	289,509
Total	$ 22,371,451	$ 23,067,696

	2012	2011
Statement of Net Assets classification		
Cash and cash equivalents	$ 22,106,774	$ 22,778,187
Endowment investments	264,677	289,509
Total	$ 22,371,451	$ 23,067,696

At June 30, 2012, the University's pooled endowment fund consisted of common and preferred stock (3.6%), pooled equity funds (37.5%), pooled private equity funds (7.5%), pooled absolute return funds (19.7%), pooled real return funds (9.5%), pooled real estate funds (6.6%), U.S. treasury fixed income (1.0%), government agency fixed income funds (1.0%), corporate fixed income funds (2.9%), pooled fixed income funds (10.5%) and cash and cash equivalents (0.2%). At June 30, 2011, the University's pooled endowment fund consisted of common and preferred stock (4.3%), pooled equity funds (38.0%), pooled private equity funds (4.7%), pooled absolute return funds (19.1%), pooled real return funds (10.4%), pooled real estate funds (5.5%), U.S. treasury fixed income (0.8%), government agency fixed income funds (1.8%), corporate fixed income funds (2.2%), pooled fixed income funds (13.1%) and cash and cash equivalents (0.1%).

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 Operating Fund Investment Policy.

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. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could affect the investment amounts in the statement of net assets.

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 for balances exceeding amounts covered by the Federal Deposit Insurance Corporation. On November 9, 2010, the FDIC Board of Directors issued a final rule to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that provides temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts at all FDIC-insured depository institutions (the "Dodd-Frank Provision"). The separate coverage for noninterest-bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012. The Association's deposits are non-interest bearing and are fully insured by FDIC coverage. 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 deposited or invested in one issuer. However, all such deposits 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, 2012, 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.

3. CAPITAL ASSETS, NET

Capital assets as of June 30, 2012 are summarized as follows:

	2012			
	Beginning Balance	Additions	Deletions	Ending Balance
Equipment	$ 5,371,181	$ 441,550	$ 448,936	$ 5,363,795
Vehicles	582,627	65,253	63,004	584,876
	5,953,808	506,803	511,940	5,948,671
Accumulated Depreciation				
Equipment	3,643,081	434,284	421,243	3,656,122
Vehicles	500,068	51,403	63,004	488,467
	4,143,149	485,687	484,247	4,144,589
Net capital assets	$ 1,810,659	$ 21,116	$ 27,693	$ 1,804,082

Capital assets as of June 30, 2011 are summarized as follows:

	2011			
	Beginning Balance	Additions	Deletions	Ending Balance
Equipment	$ 5,220,913	$ 462,052	$ 311,784	$ 5,371,181
Vehicles	582,627	-	-	582,627
	5,803,540	462,052	311,784	5,953,808
Accumulated Depreciation				
Equipment	3,438,684	480,401	276,004	3,643,081
Vehicles	446,994	53,074	-	500,068
	3,885,678	533,475	276,004	4,143,149
Net capital assets	$ 1,917,862	$ (71,423)	$ 35,780	$ 1,810,659

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2012 and 2011, are as follows:

	2012	2011
Payable to vendors and contractors	$ 1,702,108	$ 1,524,278
Due to the University of Kentucky for accrued payroll and vacation	406,920	567,653
Total	$ 2,109,028	$ 2,091,931

5. LONG TERM LIABILITIES

Long-term liabilities as of June 30, 2012 and 2011, are summarized as follows:

	2012					
	Beginning Balance	Additions	Deletions	Ending Balance	Current Portion	Noncurrent Portion
Due to the University of Kentucky		$ 6,900,000	$ -	$ 6,900,000	$ 1,344,852	$ 5,555,148
Deferred compensation	$ 872,299	2,052,843	-	2,925,142	1,000,000	1,925,142
	$ 872,299	$ 8,952,843	$ -	$ 9,825,142	$ 2,344,852	$ 7,480,290

	2011					
	Beginning Balance	Additions	Deletions	Ending Balance	Current Portion	Noncurrent Portion
Deferred compensation	$ 641,858	$ 463,977	$ 233,536	$ 872,299	$ -	$ 872,299

The reduction in deferred compensation for the fiscal year ending June 30, 2011 was the result of a contract amendment for the head men's basketball coach.

Principal maturities and interest on notes and amounts due to the University for the next five years as of June 30, 2012 are as follows:

	Principal	Interest	Total
2013	$ 1,344,852	$ 89,010	$ 1,433,862
2014	1,362,201	71,661	1,433,862
2015	1,379,773	54,089	1,433,862
2016	1,397,572	36,290	1,433,862
2017	1,415,602	18,262	1,433,864
	$ 6,900,000	$ 269,312	$ 7,169,312

On October 11, 2010, the Association entered into an unsecured internal loan agreement with the University to acquire funding for renovation of the track and field facility. In the fiscal year ending June 30, 2012, funds of $6,900,000 were transferred from the University to the renovation project. Interest shall be charged based on two-year treasury notes plus 100 basis points (1.0%). The annual interest rate will be determined March 1 and be effective for the following fiscal year. The first scheduled re-payment will be on June 30, 2013. The internal loan will be repaid by the Department of Athletics as explained in note 12.

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 $2,222,105.
- 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 $522,640.

7. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2012 and 2011 are as follows:

	2012	2011
Interest and dividends earned on endowment investments	$ 4,353	$ 4,694
Realized and unrealized gains and losses on endowment investments	(6,400)	40,167
Interest on cash and non-endowment investments	14,378	26,301
Total	$ 12,331	$ 71,162

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, 2012 and 2011, payments of capital leases for Commonwealth Stadium were $2,215,105 and $2,218,739, respectively. Payments for debt service for Memorial Coliseum for the years ended June 30, 2012 and 2011 were $522,965 and $522,940, 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, 2012 included grants to the Association of $15,769,960. The K Fund's expenses for the year ended June 30, 2011 included grants to the Association of $15,260,000 and to the University's unexpended plant funds of $2,000,000. 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 $1.00 billion 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 2011 to 2012. Settlements have not exceeded insurance coverage during the past three years.

11. RECLASSIFICATIONS

Certain reclassifications to fiscal year 2011 comparative amounts have been made to conform to the fiscal year 2012 financial statement classifications. Certain transactions previously reported as an investment in stock are now being reported as an investment in pooled equity. Such classifications had no effect on the change in net assets.

12. SUBSEQUENT EVENTS

In February 2012, the Board of Directors authorized the dissolution of the Association effective June 30, 2012. All of the debts and liabilities of the Association have been paid or assumed by the Athletics Department, an organizational unit of the University, and all assets held by the Association will transfer to the University of Kentucky according to the Articles of Dissolution of University of Kentucky Athletic Association, Inc. on July 1, 2012.

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UNIVERSITY OF KENTUCKY

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