

**KENTUCKY HIGH SCHOOL
ATHLETIC ASSOCIATION**

Report on Audited Financial Statements

For the Years Ended June 30, 2003 and 2002

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MILLER, MAYER, SULLIVAN & STEVENS LLP

CERTIFIED PUBLIC ACCOUNTANTS
"INNOVATORS OF SOLUTION TECHNOLOGY"SM

INDEPENDENT AUDITORS' REPORT

Commissioners and Board of Control
Kentucky High School Athletic Association
Lexington, Kentucky

We have audited the statements of financial position of the Kentucky High School Athletic Association (a nonprofit organization) as of June 30, 2003 and 2002, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Kentucky High School Athletic Association at June 30, 2003 and 2002, and the results of their activities and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental data included in this report is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements, and in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Miller, Mayer, Sullivan, & Stevens, LLP

Lexington, Kentucky
August 26, 2003

KENTUCKY HIGH SCHOOL ATHLETIC ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
For the Years Ended June 30, 2003 and 2002

1. NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities. The Kentucky High School Athletic Association (the Association) is a nonprofit Association organized for the purpose of development, regulation and purification of athletic activities in the Commonwealth of Kentucky.

Basis of Accounting. The financial statements of the Association have been prepared on the accrual basis of accounting.

Cash and Cash Equivalents. Cash and cash equivalents consist of cash and certificates of deposit with original maturities of three months or less.

Recognition of Donor Restrictions. The Association reports gifts of cash and other assets as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose of the restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Estimates. The preparation of financial statements in conformity with generally accepted accounting principles require management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Reclassifications. Certain presentations of accounts previously reported have been reclassified to conform to the current year presentation. Such reclassification had no effect on net assets as previously reported.

Property and Equipment. The Association reports gifts of land, buildings, and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Association reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Assets with useful lives of more than one year and a cost greater than \$500 are capitalized and depreciated over their useful life.

Property and equipment are stated at cost and are depreciated using the straight-line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Years</u>
Furniture and equipment	3-10
Building	40

Income Taxes. The Association is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

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Financial Statement Presentation. These financial statements are presented in accordance with Statement of Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations." SFAS No. 117 established standards for external financial reporting by not-for profit organizations and requires that resources be classified for accounting and reporting purposes into three classes of net asset categories according to externally (donor) imposed restrictions:

- a. Unrestricted net assets encompass the portion of net assets that are neither permanently restricted nor temporarily restricted by donor-imposed stipulations,
- b. Temporarily restricted net assets are the net assets resulting from contributions and other inflows whose use by the Association is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Association pursuant to those stipulations.
- c. Permanently restricted net assets are the net assets resulting from contributions and other inflows whose use by the Association is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Association.

Contributions. In accordance with SFAS No. 116, "Accounting for Contributions Received and Contributions Made," contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and nature of the donor restrictions.

Investments. Investments are recorded in accordance with SFAS No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organization." Under SFAS No. 124, investments in marketable securities with readily determinable fair values and all investments in debt securities are valued at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets.

Accounts Receivable. Receivable balances are stated at their unpaid balance. Management evaluates the collectibility of accounts receivable on an individual account basis and, using the specific write-off method, charges to expense the balance of accounts that are deemed not collectible. Generally accepted accounting principles requires that an allowance for uncollectible account balances be established for uncollectible account balances, and write-offs charged to the allowance account when collection efforts have been exhausted. The difference in accounting treatment is not material to these financial statements.

2. TEMPORARILY RESTRICTED AND BOARD DESIGNATED NET ASSETS

Temporarily restricted net assets are restricted for the development of the Museum, and totaled \$-0- and \$143,553 at June 30, 2003 and 2002, respectively.

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Unrestricted net assets have been designated by the Board of Control for the following purposes:

	<u>2003</u>	<u>2002</u>
Debt prepayment	\$ (5,000)	\$ 175,000
Museum development	21,095	64,774
Trademark/Novelty reserve	55,506	54,025
Officials division	26,354	34,181
Plant emergencies	48,925	16,622
Equipment replacement	63,899	43,411
Training/development reserve	34,230	12,685
Student SID Program		1,340
Title IX Project	50,642	5,322
Legal expense	50,000	60,000
Sportsmanship Scholarships	11,434	10,884
Sportsmanship Awards	650	6,195
	<u>\$ 357,734</u>	<u>\$ 484,439</u>

3. LAND, BUILDINGS, & EQUIPMENT

Land, buildings, and equipment consist of the following:

	<u>2003</u>	<u>2002</u>
Land	\$ 431,341	\$ 431,341
Building	3,192,225	3,004,768
Equipment	<u>369,162</u>	<u>365,089</u>
	3,992,728	3,801,198
Accumulated depreciation	<u>(1,161,248)</u>	<u>(1,065,637)</u>
	<u>\$ 2,831,480</u>	<u>\$ 2,735,561</u>

Depreciation expense for the years ended June 30, 2003 and 2002 was \$95,812 and \$102,589, respectively.

4. PENSIONS

- a. **Kentucky Teachers' Retirement System.** Eligible employees of the Association participate in the Statewide Kentucky Teachers' Retirement System (System), a multi-employer public employee retirement system established and administered by the Commonwealth of Kentucky to provide benefit pension plan coverage for local school districts and other public educational agencies within the state.

Chapter 161 Section 220 of the Kentucky Revised Statutes stipulates who may become a member of the Teachers' Retirement System. Generally, eligible persons are employed by local boards of education, the State Department of Education, some state universities, and some non-state

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supported organizations. Information regarding total payroll for employees covered by the System for the year ended June 30, 2003 was not available.

Employees are entitled to an annual retirement benefit, payable monthly for life, if they either attain the age of fifty-five (55) and complete five (5) years of Kentucky service or complete twenty-seven (27) years of Kentucky service. Non-university employees receive monthly payments equal to either two (2) percent (service prior to January 1, 1984) or two and one half (2½) percent (service after January 1, 1984) of their final average salaries for each year of credited service. The final average salary for employees retiring under the age of fifty-five is the average of the employee's five (5) highest annual salaries, and for employees retiring at the age of fifty-five or over, it is the average of the employee's three (3) highest annual salaries. Employees with less than twenty-seven (27) years of service may retire and receive reduced benefits. Members' retirement benefits become vested when they complete five (5) years of credited service.

Members are required by statute to contribute 9.855% of their salaries to the System. The Association contributes the remaining amounts necessary to finance the participation of employees in the System. Employer contributions are determined as a level percentage of payroll. If an employee leaves covered employment before accumulating five (5) years of credited service, accumulated employee contributions plus interest earned are refunded to the employee upon his or her request. The contributions for 2003 were \$41,297 from the Association and \$31,175 from the Commissioners. The contributions for 2002 were \$41,491 from the Association and \$31,202 from the Commissioners. The Association's contributions for 2003 and 2002 represented 13.578% and 13.793% of covered payroll.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess KTRS funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems.

Historical trend information showing the System's progress in accumulating sufficient assets to pay benefits when due is presented in the System's comprehensive annual report.

The System does not make separate measurements of assets and pension benefit obligations for individual employers. Information on the pension benefit obligation as of June 30, 2003 and the System's net assets available for benefits on that date is not available.

Based on information in the comprehensive annual report of the Teachers Retirement Systems as of June 30, 2002, the following information is provided:

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Number of active and retired members at June 30, 2002:

Retirees and beneficiaries currently receiving benefits	33,457
Terminated employees entitled to benefits, but not yet receiving them	5,995
Active Plan members	<u>54,175</u>
Total	<u><u>93,627</u></u>

Pension benefit obligation, June 30, 2002	<u>\$ 15,695,574,000</u>
Actuarial value of plan assets, June 30, 2002	<u>\$ 13,588,847,000</u>
Unfunded accrued liability, June 30, 2002	<u>\$ 2,106,726,000</u>

- b. **Kentucky Employees' Retirement System.** Certain other eligible employees participate in the Statewide Kentucky Employees' Retirement System (Plan), a multi-employer public employee retirement system, established and administered by the Commonwealth of Kentucky.

The System is a defined benefit plan which covers substantially all regular full-time employees of any state department, board, or agency directed by Executive Order to participate in the System. Information regarding total payroll for employees covered by the System for the year ended June 30, 2003 was not available.

Eligible members of the Kentucky Retirement Systems are entitled to an annual retirement benefit, payable monthly for life, if they either attain the age of 65 and have 48 or more months of service or accumulate 27 years of service credit. The monthly retirement allowance is equal to 1.97% of the average annual salary of the members' five highest earnings years multiplied by the number of years of service credit divided by twelve. Members retiring at less than 55 years of age with 25 or more years of service credit are entitled to reduced benefits. Members' retirement benefits become fully vested when they complete sixty months of service, twelve of which are current service.

For the year ended June 30, 2002, participating employees contributed 5% of creditable compensation to the System. Employer contribution rates are intended to fund the System's normal cost on a current basis plus one percent (1%) of unfunded past service costs per annum plus interest at the actuarial assumed rate. Such contribution rates are determined by the Board of Trustees of Kentucky Retirement Systems each biennium. Participating employers contributed at 5.89% of members' non-hazardous compensation for the year ended June 30, 2002.

The contribution requirement for the year ended June 30, 2003 was \$17,567. The contributions for 2002 consisted of \$9,509 from the Association and \$8,058 from the employees. The contribution requirement for the year ended June 30, 2002 was \$16,579. The contributions for 2002 consisted of \$8,465 from the Association and \$8,114 from the employees.

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The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date. The measure is the actuarial present value of credited projected benefits and is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems (PERS). The measure is independent of the actuarial funding method used to determine contribution to the System.

The Plan does not make separate measurements of assets and pension benefit obligations for individual employers. Information on the pension benefit obligation as of June 30, 2003 and the Plan's net assets available for benefits on that date is not available.

Based on information in the comprehensive report of the Plan for the year ended June 30, 2002, the following information is provided:

Number of active and retired members at June 30, 2002:

Retirees and beneficiaries currently receiving benefits	27,911
Terminated plan members -- vested	3,542
Terminated plan members -- non-vested	15,245
Active plan members	<u>52,766</u>
	<u>99,464</u>
Pension benefit obligation, June 30, 2002	<u>\$ 6,348,164,000</u>
Actuarial value of plan assets, June 30, 2002	<u>\$ 7,030,468,000</u>
Excess funding, June 30, 2002	<u>\$ 682,305,000</u>

5. ACCRUED SICK LEAVE

Association employees are granted sick leave in accordance with administrative policy. Employees earn one day per month with unlimited accumulation. Employees are compensated for 30% of unused accumulated sick leave upon retirement. Compensation shall be the daily rate of pay being received at the time of retirement, based upon 260 work days per year.

As of June 30, 2003 and 2002, the estimated accrued sick leave liability is \$73,013 and \$53,526, respectively.

6. NOTES PAYABLE

On February 1, 1994, the Association entered into a loan agreement with the Lexington-Fayette Urban County Government relating to the Industrial Building Revenue Refunding Bonds (KHSAA PROJECT) of 1994. The Lexington-Fayette Urban County Government issued Industrial Building Revenue Bonds that were sold in a private sale to The Fifth Third Bank of Central Kentucky, Inc. The Association signed a fifteen year promissory note with the Lexington-Fayette Urban County

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For the Years Ended June 30, 2003 and 2002

Government. Interest on the note was 5.1% through and including January 31, 1999, to be adjusted each fifth year. Effective February 1, 1999, the rate was renegotiated to 5.4% fixed through the remaining life of the loan. Payments on the promissory note have been irrevocably assigned to The Fifth Third Bank as trustee. The balance of the loan was \$904,852 and \$1,246,847 at June 30, 2003 and 2002, respectively.

The terms of the loan agreement require, among other covenants, the following:

- Annual audited financial statements,
- Prior written consent before assets are transferred, pledged or encumbered,
- Maintenance of nonprofit and tax exempt status,
- Prior approval of additional indebtedness greater than \$50,000,
- Cash flow coverage of 1.2 to 1, and
- Maintenance of a debt service reserve fund.

Cash flow coverage is defined as the ratio of the sum of the increase in net assets plus depreciation plus interest expense to the sum of current maturities of long-term debt plus interest expense, as such appear on the audited financial statement. The Association had a cash flow coverage ratio of .52 to 1 for the year ended June 30, 2003 and .87 to 1 for the year ended June 30, 2002.

The debt service reserve fund is required to be "the least of (i) maximum annual debt service on the Bonds, (ii) 125% of average annual debt service on the Bonds or (iii) 10% of the principal amount of the Bonds, provided that in no event shall any portion of the Debt Service Reserve Fund funded with proceeds from the sale of the bonds exceed 10% of the sale proceeds of the Bonds." At June 30, 2003 and 2002, the debt service reserve was \$224,000.

The expected principal payments over the next five year period and thereafter are as follows:

<u>Fiscal Year</u>	<u>Principal Obligation</u>
2004	\$ 178,773
2005	188,931
2006	199,538
2007	210,741
2008	<u>126,869</u>
	<u>\$ 904,852</u>

Interest expense for the year ended June 30, 2003 and 2002 totaled \$62,004 and \$72,207, respectively. Debt issuance costs of \$120,331 associated with the issuance of the debt are amortized over the life of the loan (15 years) and are presented on the balance sheet net of amortization of \$42,718 and \$51,475 for the years ended June 30, 2003 and 2002, respectively.

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NOTES TO FINANCIAL STATEMENTS
For the Years Ended June 30, 2003 and 2002

7. CASH ON DEPOSIT WITH BANKS

As of June 30, 2003, the carrying amount of Kentucky High School Athletic Associations' cash deposits with banks was \$744,105, and the actual bank balance was \$912,649. Of the bank balance, \$163,572 was covered by federal depository insurance, and \$749,077 was collateralized in conjunction with other public service accounts by designated funds at Fifth Third Bank.

8. INVESTMENTS

Restricted investments at June 30, 2003 consisted of the following:

	<u>Par</u>	<u>Cost</u>	<u>Market</u>	<u>Rate</u>	<u>Maturity</u>
U.S. Treasury Note	\$ 225,000	\$ 224,271	\$ 224,271	.83%	11/20/03
Money Market account	23,887	23,887	23,887	.63%	
Totals	<u>\$ 248,887</u>	<u>\$ 248,158</u>	<u>\$ 248,158</u>		

Unrestricted investments at June 30, 2003 consisted of the following:

	<u>Par</u>	<u>Cost</u>	<u>Market</u>	<u>Rate</u>	<u>Maturity</u>
Money market account	\$ 400,000	\$ 400,000	\$ 400,000	0.33%	

Restricted investments at June 30, 2002 consisted of the following:

	<u>Par</u>	<u>Cost</u>	<u>Market</u>	<u>Rate</u>	<u>Maturity</u>
U.S. Treasury Note	\$ 227,000	\$ 224,911	\$ 225,139	1.42%	12/20/02
Money Market account	123,385	123,385	123,385	1.00%	
Totals	<u>350,385</u>	<u>348,296</u>	<u>348,524</u>		

Unrestricted investments at June 30, 2002 consisted of the following:

	<u>Par</u>	<u>Cost</u>	<u>Market</u>	<u>Rate</u>	<u>Maturity</u>
Federal Home Loan Bond	\$ 405,000	\$ 401,445	\$ 401,679	1.87%	12/20/02
Federal Home Loan Bond	210,000	208,378	208,425	1.80%	12/05/02
Totals	<u>615,000</u>	<u>609,823</u>	<u>610,104</u>		

In addition, the Association has funds invested in a money market account, which are designated for the Museum. The balance in this account was \$122,299 and \$258,500 as of June 30, 2003 and 2002, respectively.

KENTUCKY HIGH SCHOOL ATHLETIC ASSOCIATION
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For the Years Ended June 30, 2003 and 2002

Total investment return for the years ended June 30, 2003 and 2002 are as follows:

	<u>2003</u>	<u>2002</u>
Interest earned	\$ 14,185	\$ 45,651
Unrealized gain (loss) on investments	_____	508
Total investment return	<u>\$ 14,185</u>	<u>\$ 46,159</u>

In fiscal year 1999, the Association entered into a repurchase agreement with Fifth Third Bank. Under this agreement, the Bank does not segregate the securities to be sold and repurchased. However, the Association's interest in the underlying securities was noted in the Bank's records. The securities were held as collateral for the Association's investment. The Association cannot resell, pledge, assign, or otherwise dispose of the securities so purchased.

9. CONCENTRATIONS OF CREDIT RISK

Major Activities. The Association earned \$1,282,692 and \$1,215,314 in gross revenue from the Boys State Basketball Tournament for the years ended June 30, 2003 and 2002, respectively. This represents approximately 43% of the Association's total gross revenues and support for 2003 and 2002, respectively.

The Association earned \$452,291 and \$448,740 in fees from member schools and officials for the years ended June 30, 2003 and 2002, respectively. These fees represent approximately 16% and 15% of the Association's total gross revenues and support for 2003 and 2002, respectively.

10. Subsequent Events

Subsequent to June 30, 2003, the Association received a waiver for non-compliance with the "Cash Flow Coverage" covenant for the year ending June 30, 2003. This waiver releases the Association from call provisions on its debt to Fifth Third Bank of Central Kentucky, Inc. only as it pertains to the year ended June 30, 2003 and 2002.

11. Deferred Revenues

Deferred revenues consist of the following:

	<u>2003</u>	<u>2002</u>
Unearned dues paid by member schools	\$ 35,200	\$ 31,400
Unearned portion of museum support contract	83,428	50,000
Unearned registration fees paid by officials	89,069	_____
	<u>\$ 207,697</u>	<u>\$ 81,400</u>

SUPPLEMENTAL DATA

KENTUCKY HIGH SCHOOL ATHLETIC ASSOCIATION
STATEMENT OF FUNCTIONAL EXPENSES

For the Year Ended June 30, 2003

With Comparative Totals for the Year Ended June 30, 2002

	General and Administrative	Boys State Basketball Tournament	Girls State Basketball Tournament	Football Playoffs	Track	Hall of Fame Events	Tennis	Cross Country	Soccer	Softball	Golf	Other Sports	Fund Raising	2003 Total Expenses	2002 Total Expenses
Personnel	\$ 687,190	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$ 687,190	\$ 655,101
Insurance	145,994													145,994	121,289
Interest expense	65,432													65,432	72,207
Depreciation	95,812													95,812	102,589
Professional fees	243,332													243,332	298,380
Printing and publications	130,044	35,661	20,623	12,980	3,521		326	1,736	2,212	3,082	1,780	11,425		223,330	219,049
Professional development	18,338													18,338	23,302
Dues	40,610													40,610	33,880
Utilities and telephone	56,611													56,611	66,043
Postage	40,310													40,310	58,253
Board of Control	42,294													42,294	48,289
Administrative travel	16,989													16,989	22,259
Repairs and maintenance	76,685													76,685	49,024
Amortization of debt cost	8,757													8,757	8,022
Miscellaneous	105,907													105,907	117,207
Tournament facility rental		196,998	1,550	18,457	3,459		1,840	5,095	13,815	1,360	3,000	3,805		249,379	224,114
Team expenses and awards		48,536	53,566	17,527	15,979		6,041	6,181	10,254	26,535	5,804	34,044		224,467	192,445
Tournament workers		20,735	21,109	11,265	10,251		2,224	3,259	11,283	9,826	2,755	34,347		127,054	120,230
Radio network		89,345	15,738											105,083	74,779
Sponsorship expense		5,441	2,673											8,114	6,110
Other event costs	73,707	17,223	10,779	10,076	6,910	28,265	4,734	3,183	3,962	121	454	8,109		167,523	179,677
Audio visual expense		155	570	2,900					460	1,011		910		6,006	19,309
Clinics and officials' expenses	68,848													68,848	53,738
Auto and cell phone usage	28,471													28,471	28,031
Sales commissions			1,148	2,225				334	253				22,533	32,012	32,190
Total expenses	\$ 1,945,331	\$ 419,553	\$ 127,756	\$ 75,430	\$ 40,120	\$ 28,265	\$ 15,165	\$ 19,788	\$ 42,239	\$ 41,935	\$ 13,793	\$ 92,640	\$ 22,533	\$ 2,884,548	\$ 2,825,517

The accompanying notes are an integral part of the financial statements.