

## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors  
American Quarter Horse Association  
Amarillo, Texas

### **Report on Financial Statements**

We have audited the accompanying consolidated statement of financial position of the American Quarter Horse Association and American Quarter Horse Foundation (collectively, the Association) as of September 30, 2013, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

To the Board of Directors  
American Quarter Horse Association  
Amarillo, Texas

We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the American Quarter Horse Association and American Quarter Horse Foundation as of September 30, 2013, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Prior Period Financial Statements***

The consolidated statement of financial position of the American Quarter Horse Association and American Quarter Horse Foundation as of and for the year ended September 30, 2012, were audited by other auditors whose report dated January 9, 2013, expressed an unmodified opinion on those statements.

*Mess Adams LLP*

Albuquerque, New Mexico  
January 30, 2014

## AMERICAN QUARTER HORSE ASSOCIATION CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

### ASSETS

|   | September 30,        |                      |
|---|----------------------|----------------------|
|   | 2013                 | 2012                 |
| <b>CURRENT ASSETS</b>                               |                      |                      |
| Cash and cash equivalents                           | \$ 1,059,163         | \$ 938,749           |
| Cash and cash equivalents designated for investment | 2,907,846            | 3,985,098            |
| Accounts receivable, net                            | 2,046,772            | 1,669,719            |
| Contributions receivable, net                       | 1,073,990            | 3,901,387            |
| Investments   | 70,310,107           | 64,580,272           |
| Property and equipment, net                         | 16,474,714           | 20,059,549           |
| Prepaid expenses and other assets                   | 1,900,904            | 1,820,639            |
|   | <b>\$ 95,773,496</b> | <b>\$ 96,955,413</b> |

### LIABILITIES AND NET ASSETS

|   |                      |                      |
|---|----------------------|----------------------|
| <b>CURRENT LIABILITIES</b>                          |                      |                      |
| Trade accounts payable and accrued expenses         | \$ 3,068,422         | \$ 3,126,928         |
| Incentive fund and racing challenge deferred income | 11,660,356           | 12,029,155           |
| Other deferred income                               | 16,603,097           | 18,489,385           |
| Current portion of note payable                     | 114,035              | -                    |
| Liability for pension benefits                      | 3,942,383            | 7,891,118            |
|   | <b>35,388,293</b>    | <b>41,536,586</b>    |
| <b>LONG TERM LIABILITY</b>                          |                      |                      |
| Note payable  | 448,832              | -                    |
|   | <b>35,837,125</b>    | <b>41,536,586</b>    |
| <b>COMMITMENTS AND CONTINGENCIES (Note 11)</b>      |                      |                      |
| <b>NET ASSETS</b>                                   |                      |                      |
| Unrestricted  | 34,208,447           | 33,077,429           |
| Temporarily restricted                              | 3,072,926            | 1,059,503            |
| Permanently restricted                              | 22,654,998           | 21,281,895           |
|   | <b>59,936,371</b>    | <b>55,418,827</b>    |
|   | <b>\$ 95,773,496</b> | <b>\$ 96,955,413</b> |

## AMERICAN QUARTER HORSE ASSOCIATION CONSOLIDATED STATEMENTS OF ACTIVITIES

|  | Years Ended September 30, |               |
|--|---------------------------|---------------|
|  | 2013                      | 2012          |
| <b>UNRESTRICTED NET REVENUES</b>                                       |                           |               |
| Operating revenues   |                           |               |
| Memberships and member services  |                           |               |
| Memberships  | \$ 7,007,585              | \$ 7,489,803  |
| Registrations  | 4,159,380                 | 4,541,959     |
| Transfers  | 1,761,093                 | 1,922,065     |
| Stallion breeding report fees and late fees                            | 1,502,002                 | 1,628,072     |
| Genotyping/blood typing  | 1,896,220                 | 2,090,775     |
| Drug testing   | 1,358,234                 | 1,831,878     |
| World championship shows   | 6,002,602                 | 5,604,060     |
| Sponsorships   | 6,424,801                 | 6,540,466     |
| Publication advertising  | 1,488,235                 | 1,893,427     |
| Publication circulation  | 1,167,472                 | 1,270,536     |
| Incentive Fund and Racing Challenge programs                           | 5,959,587                 | 5,631,692     |
| Gift store sales   | 1,123,065                 | 1,024,058     |
| Other  | 3,987,669                 | 4,270,370     |
| Total operating revenues   | 43,837,945                | 45,739,161    |
| Net assets released from restriction                                   | 2,397,956                 | 1,648,898     |
| Total operating revenues and other support                             | 46,235,901                | 47,388,059    |
| <b>OPERATING EXPENSES</b>  |                           |               |
| Program expenses   |                           |               |
| Shows  | 12,138,954                | 12,612,118    |
| Publications   | 5,901,522                 | 6,449,755     |
| Racing   | 4,880,591                 | 4,755,002     |
| Marketing  | 4,502,483                 | 4,648,792     |
| Member services  | 3,964,573                 | 4,315,340     |
| Registration   | 3,891,169                 | 3,865,745     |
| Foundation program expenses  | 3,718,729                 | 3,681,058     |
| General and administrative   | 9,843,575                 | 9,846,802     |
| Fundraising  | 491,377                   | 512,080       |
| Total operating expenses   | 49,332,973                | 50,686,692    |
| Decrease in unrestricted net assets from operations                    | (3,097,072)               | (3,298,633)   |
| <b>OTHER ACTIVITIES</b>  |                           |               |
| Investment return  | 4,383,851                 | 4,967,407     |
| Pension plan actuarial gain (loss) recognized                          | 3,774,138                 | (1,531,715)   |
| (Loss) gain on disposal of software                                    | (3,823,954)               | 3,623         |
| Uncollectible pledges  | (105,945)                 | (73,186)      |
| Total other activities   | 4,228,090                 | 3,366,129     |
| Increase in unrestricted net assets                                    | 1,131,018                 | 67,496        |
| <b>TEMPORARILY RESTRICTED NET ASSETS</b>                               |                           |               |
| Contributions  | 2,016,099                 | 673,887       |
| Investment return  | 2,342,192                 | 1,526,065     |
| Net assets released from restrictions and changes in donor designation | (2,344,868)               | (1,648,898)   |
| Increase in temporarily restricted net assets                          | 2,013,423                 | 551,054       |
| <b>PERMANENTLY RESTRICTED NET ASSETS</b>                               |                           |               |
| Contributions  | 1,486,380                 | 2,990,848     |
| Uncollectible pledges  | (147,335)                 | (150,000)     |
| Investment return  | 87,146                    | -             |
| Reclassification due to change in donor designation                    | (53,088)                  | -             |
| Increase in permanently restricted net assets                          | 1,373,103                 | 2,840,848     |
| Increase in net assets   | 4,517,544                 | 3,459,398     |
| <b>NET ASSETS, beginning of year</b>                                   | 55,418,827                | 51,959,429    |
| <b>NET ASSETS, end of year</b>   | \$ 59,936,371             | \$ 55,418,827 |

## AMERICAN QUARTER HORSE ASSOCIATION

### CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | Years Ended September 30, |              |
|--|---------------------------|--------------|
|  | 2013                      | 2012         |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                           |              |
| Increase in net assets   | \$ 4,517,544              | \$ 3,459,398 |
| Adjustments to reconcile change in net assets to net cash<br>from operating activities |                           |              |
| Depreciation and amortization  | 1,812,973                 | 1,833,224    |
| Loss (gain) on disposal of software and equipment                                      | 3,823,954                 | (3,623)      |
| Net appreciation on investments  | (6,807,344)               | (6,018,409)  |
| Change in pension liability  | (3,948,735)               | 1,720,776    |
| Noncash gifts received   | -                         | (6,590)      |
| Changes in operating assets and liabilities  |                           |              |
| Cash and cash equivalents designated for investment                                    | 1,077,252                 | 7,126,220    |
| Accounts and contributions receivable, net   | 2,450,344                 | (567,067)    |
| Prepaid expenses and other assets  | (80,265)                  | 54,957       |
| Trade accounts payable and accrued expenses  | (58,506)                  | (553,410)    |
| Other deferred income  | (1,886,288)               | (440,760)    |
| Incentive Fund and Racing Challenge deferred income                                    | (368,799)                 | (327,471)    |
|  | 532,130                   | 6,277,245    |
| <b>Net cash provided by operating activities</b>                                       |                           |              |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                           |              |
| Purchases of investments   | (18,238,804)              | (22,256,761) |
| Proceeds from sales and maturities of investments                                      | 19,316,315                | 17,148,977   |
| Purchase of property and equipment   | (2,107,939)               | (1,208,986)  |
| Proceeds from sale of property and equipment   | 55,845                    | 27,943       |
|  | (974,583)                 | (6,288,827)  |
| <b>Net cash used by investing activities</b>   |                           |              |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                           |              |
| Proceeds from long term note payable   | 600,000                   | -            |
| Payment on note payable  | (37,133)                  | -            |
|  | 562,867                   | -            |
| <b>Net cash provided by financing activities</b>                                       |                           |              |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>   | 120,414                   | (11,582)     |
| <b>CASH AND CASH EQUIVALENTS, beginning of year</b>                                    | 938,749                   | 950,331      |
| <b>CASH AND CASH EQUIVALENTS, end of year</b>  | \$ 1,059,163              | \$ 938,749   |

## AMERICAN QUARTER HORSE ASSOCIATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Note 1 – Organization

The American Quarter Horse Association (AQHA) was formed and exists for the purpose of collecting, recording and preserving the pedigrees of Quarter Horses, and stimulating and regulating matters which pertain to the history, breeding, exhibition, publicity, racing or improvement of the Quarter Horse breed.

The American Quarter Horse Foundation (AQHF) was formed to encourage, by public contribution, support of worthwhile educational and charitable projects of interest and benefit to devotees of the American Quarter Horse. In addition, AQHF operates the American Quarter Horse Hall of Fame and Museum (the Hall of Fame), which opened in 1991. The Hall of Fame is devoted to honoring the American Quarter Horse and those responsible for the success of the breed. The Executive Committee of AQHA serves as the Board of Trustees of AQHF.

### Note 2 – Summary of Significant Accounting Policies

**Financial statements presentation** – The Association's consolidated financial statements are reflected on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts and transactions of AQHA and AQHF (collectively, the Association). All material intercompany balances and transactions have been eliminated. The Association reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. AQHA has majority voting and economic interest in AQHF, and therefore the AQHA financial statements have been consolidated with the AQHA financial statements.

**Unrestricted net assets** – are assets not subject to stipulations imposed by the donor and are currently available for expenditures. Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by explicit donor restrictions. Contributions are reported as unrestricted where donor-imposed restrictions are met in the same reporting period as they are received. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or law. Unrestricted net assets include net assets transferred from temporarily restricted net assets after temporary restrictions imposed by the donor have been accomplished or the stipulated time period has elapsed. A donor's restriction, however, may be released or modified by the donor, a court, or in the circumstances and manner set forth in the Uniform Prudent Management of Institutional Funds Act.

**Temporarily restricted net assets** – are assets subject to explicit restrictions imposed by the donor on the expenditure of contributions or income and gains on contributed assets. The temporary restrictions may expire due to the passage of time or the occurrence of expenditures that fulfill the restrictions. Temporarily restricted net assets also include accumulated net investment income earned by the permanently restricted net assets, except for net investment income permanently restricted by the donor.

## AMERICAN QUARTER HORSE ASSOCIATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### Note 2 – Summary of Significant Accounting Policies (continued)

**Permanently restricted net assets** – are assets subject to explicit stipulations imposed by the donor to be maintained in perpetuity. Permanently restricted net assets consist of contributions and pledges specifically restricted by the donor for the purpose of forming a permanent endowment to generate income.

**Use of estimates** – The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and cash equivalents and cash and cash equivalents designated for investments** – For purposes of the consolidated statements of cash flows, the Association considers all cash and other highly liquid investments with initial maturities of three months or less to be cash equivalents. Cash and cash equivalents available for investment are held to be redeployed in investments and held in various investment accounts. The Association maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Association has not experienced any losses related to these concentrations.

**Contributions receivable** – Contributions receivable that are expected to be collected within one year are recorded at net realizable value. Contributions receivable that are expected to be collected in future years are recorded at the present value of the expected future cash flows using a discount rate.

An allowance for uncollectible accounts is estimated by management based on its historical loss analysis and is adjusted for those specific contributions receivable for which collection is uncertain. Such amounts will be written-off if and when they are deemed uncollectible.

**Accounts receivable** – Accounts receivable are included in the accompanying consolidated statements of financial position at original invoice net of the allowance for doubtful accounts. The accounts receivable balance is comprised of amounts owed to the Association for gift shop purchases, sponsorships, journal advertising and other miscellaneous receivables.

The Association determines its allowance based on specific uncollectible accounts. The Association writes off receivables when they become uncollectible. The Association has had minimal losses on accounts receivable in prior years. The allowance for doubtful accounts at September 30, 2013 and 2012 is approximately \$1,600 and \$1,000, respectively.

**Investments** – Investments consist of equity mutual funds, domestic and common stock, and real estate partnerships which are recorded at fair value in accordance with ASC 820 *Fair Value Measurements and Disclosures* (Note 4). Realized and unrealized gains and losses are recognized in the statement of activities.

## AMERICAN QUARTER HORSE ASSOCIATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Note 2 – Summary of Significant Accounting Policies (continued)

**Property and equipment** – Property and equipment are recorded at cost or estimated fair value at the date of donation. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets over their estimated service lives of approximately 35 to 40 years on buildings and improvements and 3 to 10 years on furniture and equipment on a straight-line basis.

**Collections and exhibits** – AQHF has capitalized collections since its inception. Collections and exhibits are recorded at cost or estimated fair value at the date of donation and are included in property and equipment. Collections consist primarily of donated art objects where fair value at the date of contribution is determined by appraisal. Depreciation is provided for in amounts sufficient to relate the cost of exhibits over their estimated service lives of approximately 5 to 15 years on a straight-line basis. No depreciation has been provided for collections which are limited works of a rare nature. Gains or losses on the disposition of collections and exhibits are recorded in the consolidated statement of activities at the time of disposition and are classified as unrestricted or temporarily restricted depending on donor restrictions, if any, placed on the item at the date of donation.

**Impairment of long-lived assets** – The Association reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or the fair value less costs to sell. As of September 30, 2013 and 2012, the Association's management has not recognized impairment on any long-lived assets.

**Income taxes** – AQHA is qualified under Section 501 of the Internal Revenue Code (IRC); therefore, the majority of its income is exempt from federal income tax under the provisions of Section 501(c)(5). Income from certain operations of AQHA, primarily advertising in its publications, is taxable for federal income tax purposes. For the years ended September 30, 2013 and 2012, AQHA did not incur any federal income tax expense. All other operations of AQHA are exempt from federal income tax. AQHF claims exemption from federal income taxes under Section 501(c)(3) of the IRC and is recognized as a public charity under Section 509(a)(3) of the IRC.

Financial Accounting Standards Board (FASB) provides guidance for how uncertain tax positions should be recognized, measured, disclosed and presented in the financial statements. This requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Association's tax return to determine whether the tax positions are "more-likely-than-not" of being sustained "when challenged" or "when examined" by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax benefit or expense and liability in the current year. Management has determined that there are no material uncertain income tax positions. The Association is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2009.

## AMERICAN QUARTER HORSE ASSOCIATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### Note 2 – Summary of Significant Accounting Policies (continued)

**Revenue recognition** – The primary sources of revenue for the Association are recognized as follows:

*Contributions:* The Association recognizes contribution revenue at the time of donation or when an unconditional promise to give is made by the donor. Contributions are recorded as either unrestricted, temporarily restricted, or permanently restricted in accordance with donor restrictions, if any.

*Memberships and member services:* Association memberships are deferred and recognized as income during the membership period; lifetime memberships are amortized on a straight-line basis over an estimated life of 10 years. Amounts received for registration, transfer and other member services are reflected in income as the required process is completed.

*World Championship Show:* Income from shows is deferred and recognized as income in the period in which the show takes place.

*Sponsorships:* Sponsorship income is deferred and recognized as income in accordance with the terms of various sponsorship agreements.

*Publications, advertising and circulation:* Subscriptions for the Association's trade publications are deferred and recognized as income during the subscription period.

*Incentive Fund and Racing Challenge programs:* All Incentive Fund receipts and investment earnings (losses) are credited to deferred income until incurred. The Association recognizes revenue and expense for these programs for the amount of prize monies and purse awards paid (see Note 6).

**Functional allocation of expenses** – The costs of providing the activities of the Association have been summarized on a functional basis in the consolidated statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

#### Note 3 – Contributions Receivable

At September 30, 2013 and 2012, contributions receivable are as follows:

|                                     | 2013                | 2012                |
|-------------------------------------|---------------------|---------------------|
| Within one year                     | \$ 889,036          | \$ 3,325,780        |
| One to five years                   | 374,401             | 829,481             |
| After five years                    | 62,842              | 154,188             |
| Total                               | 1,326,279           | 4,309,449           |
| Allowance for doubtful accounts     | (127,722)           | (191,894)           |
| Unamortized discount                | (124,567)           | (216,168)           |
| Total contributions receivable, net | <u>\$ 1,073,990</u> | <u>\$ 3,901,387</u> |

## AMERICAN QUARTER HORSE ASSOCIATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Note 4 – Fair Value Measurements

Accounting Standard Codification 820 *Fair Value Measurements and Disclosure* establishes a fair value hierarchy that prioritized the inputs to valuation techniques used to measure fair value into three broad levels. Inputs refer broadly to the assumptions that market participants would use in pricing the asset or liability.

Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances.

The objective of the fair value measurement is to determine the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Valuation techniques used to measure fair value shall maximize the use of observable inputs and minimize the use of unobservable inputs.

The fair value hierarchy prioritizes the inputs into valuation techniques to measure fair value into three broad levels. They are as follows:

**Level 1** – are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

**Level 2** – are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly through corroboration with observable market data.

**Level 3** – are unobservable inputs for the asset or liability that are inputs that reflect the Association's own assumptions about the assumptions market participants would use in pricing the asset or liability.

The fair value hierarchy gives the highest priority for quoted prices (unadjusted) in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3).

Securities classified within Level 3 investments are based on valuations provided by the external investment managers. The Investment Committee, in conjunction with the external investment advisor, monitors and analyzes the valuation of the investments on a quarterly basis. The Investment Committee reports to the Board of Trustees. The valuations consider variables such as financial performance of investments, recent sales prices of investments, and other pertinent information.

## AMERICAN QUARTER HORSE ASSOCIATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### Note 4 – Fair Value Measurements (continued)

Equity Mutual Funds, Domestic Common Stock and International Common Stock – these classifications consist of investments in various funds and securities that have differing investment goals that are traded in an active market.

Real Estate Partnerships – this classification is invested in a portfolio of real property located in the United States. The General Partner of each partnership has the authority and discretion to manage and control the affairs of the Partnership, including selecting real property to invest in and when to sell owned assets. Investments held by the limited partnership generally are carried at fair value as determined by the respective general partners and may be based on various pricing models. The fair values of the investments in this category have been determined using the practical expedient methodology and are therefore valued at net asset value. The ability to liquidate these investments in the limited partnerships are restricted in accordance with the provisions of the partnership agreements, which state that invested capital is not returned until the dissolution of the partnerships.

The investment policy allows for a certain range of the investment portfolio to be invested in alternative investment instruments. The Association's investments in these alternative investment instruments are carried at the aggregate net asset value of the shares held by the Association. The net asset value is based on the net market value of the alternative investment instrument's investment portfolio as determined by the management of the alternative investment instrument. The Association's investments in alternative investment instruments are in limited partnerships, which invest in real estate assets.

The inputs or methodology used for valuing financial instruments are not necessarily an indication of the risks associated with investing in those instruments. Investments may be exposed to various risks such as interest rate, market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term could affect investment balances and the amounts reported in the financial statements.

The Association assesses the levels of the investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with the Foundation's accounting policy regarding the recognition of transfers between levels of the fair value hierarchy. For the years ended September 30, 2013 and 2012, there were no significant transfers among fair value levels.

Investments at September 30, 2013 are as follows:

|                            | Level 1                     | Level 2                     | Level 3                     | Total                       |
|----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Equity mutual funds        | \$ 49,494,760               | \$ -                        | \$ -                        | \$ 49,494,760               |
| Domestic common stock      | 16,581,952                  | -                           | -                           | 16,581,952                  |
| International common stock | -                           | -                           | -                           | -                           |
| Real estate partnerships   | -                           | -                           | 4,233,395                   | 4,233,395                   |
|                            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| Total                      | <u>\$ 66,076,712</u>        | <u>\$ -</u>                 | <u>\$ 4,233,395</u>         | <u>\$ 70,310,107</u>        |

**AMERICAN QUARTER HORSE ASSOCIATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 4 - Fair Value Measurements (continued)**

Investments at September 30, 2012 are as follows:

|                            | <u>Level 1</u>       | <u>Level 2</u> | <u>Level 3</u>      | <u>Total</u>         |
|----------------------------|----------------------|----------------|---------------------|----------------------|
| Equity mutual funds        | \$ 48,621,051        | \$ -           | \$ -                | \$ 48,621,051        |
| Domestic common stock      | 11,313,335           | -              | -                   | 11,313,335           |
| International common stock | 99,290               | -              | -                   | 99,290               |
| Real estate partnerships   | -                    | -              | 4,546,596           | 4,546,596            |
| Total                      | <u>\$ 60,033,676</u> | <u>\$ -</u>    | <u>\$ 4,546,596</u> | <u>\$ 64,580,272</u> |

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying statement of financial position using significant unobservable (Level 3) inputs:

| 2013                                 | <u>Real Estate<br/>Partnerships</u> |
|--------------------------------------|-------------------------------------|
| Beginning balance at October 1, 2012 | \$ 4,546,596                        |
| Total unrealized loss                | <u>(313,201)</u>                    |
| Total                                | <u>\$ 4,233,395</u>                 |
|                                      |                                     |
| 2012                                 | <u>Real Estate<br/>Partnerships</u> |
| Beginning balance at October 1, 2011 | \$ 5,039,417                        |
| Total unrealized loss                | <u>(492,821)</u>                    |
| Total                                | <u>\$ 4,546,596</u>                 |

## AMERICAN QUARTER HORSE ASSOCIATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### Note 4 – Fair Value Measurements (continued)

The following tables provide additional information that describe the nature and risk of the investments held at September 30, 2013 that are recorded at fair value measured using net asset value.

The following are the commitment and redemption provisions for Level 3 investments held:

|   | Fair Value at<br>September 30,<br>2013 | Redemption<br>Frequency<br>(if currently<br>eligible) | Redemption<br>Notice<br>Period | Unfunded<br>Commitments |
|---|--|---|--------------------------------|-------------------------|
| JM Texas Land Fund No. 4, L.P.          | \$ 2,697,704                           | N/A, redemption<br>upon dissolution                   | N/A                            | \$ -                    |
| New Boston Institutional Fund, L.P., VI | <u>1,535,691</u>                       | N/A, redemption<br>upon dissolution                   | N/A                            | -                       |
| Ending Balance, September 30, 2013      | <u>\$ 4,233,395</u>                    |   |                                |                         |

The following schedule summarizes the investment return and its classification in the consolidated statement of activities for the years ended September 30, 2013 and 2012:

|                                   | 2013                | 2012                |
|-----------------------------------|---------------------|---------------------|
| Interest and dividends            | \$ 1,507,418        | \$ 1,506,004        |
| Net realized and unrealized gains | <u>5,305,771</u>    | <u>4,987,468</u>    |
| Total return on investments       | <u>\$ 6,813,189</u> | <u>\$ 6,493,472</u> |

#### Note 5 – Property and Equipment

At September 30, 2013 and 2012, property and equipment consisted of the following:

|                                  | 2013                 | 2012                 |
|----------------------------------|----------------------|----------------------|
| Depreciable assets               |                      |                      |
| Land                             | \$ 420,772           | \$ 420,772           |
| Building and improvements        | 17,340,467           | 16,797,229           |
| Furniture and equipment          | 9,748,031            | 12,132,468           |
| Collections and exhibits         | 3,984,156            | 3,982,269            |
|                                  | <u>31,493,426</u>    | <u>33,332,738</u>    |
| Accumulated depreciation         | <u>(16,786,207)</u>  | <u>(14,973,234)</u>  |
| Total depreciable assets         | 14,707,219           | 18,359,504           |
| Non-depreciable art and exhibits | <u>1,767,495</u>     | <u>1,700,045</u>     |
| Total                            | <u>\$ 16,474,714</u> | <u>\$ 20,059,549</u> |

## AMERICAN QUARTER HORSE ASSOCIATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 6 – Incentive Fund and Racing Challenge Program Deferred Income

**Incentive Fund** - The AQHA Incentive Fund is a program whereby AQHA sanctioned show participants and breeders win cash prizes based on total points accumulated during each show year. In order to be eligible, breeders must pay nomination fees for their stallions and foals. The nomination fees and the related investment income represent the source of funds for the cash prizes awarded. Nominated stallions and foals are eligible to receive payments from the Incentive Fund based on total show points earned during the previous year.

The following is a summary of activity of the Incentive Fund for the years ended September 30, 2013 and 2012:

|                                    | <u>2013</u>         | <u>2012</u>         |
|------------------------------------|---------------------|---------------------|
| Balance of fund, beginning of year | \$ 7,665,839        | \$ 8,030,912        |
| Nomination receipts                | 1,519,076           | 1,748,049           |
| Investment income                  | 766,595             | 636,493             |
| Incentive fund disbursements       | <u>(2,811,457)</u>  | <u>(2,749,615)</u>  |
| Balance of fund, end of year       | <u>\$ 7,140,053</u> | <u>\$ 7,665,839</u> |

The investment balance allocated to the Incentive Fund as of September 30, 2013 and 2012 is included in the investment balance shown on the statements of financial position.

**Racing Challenge** – The AQHA Racing Challenge is an incentive-type program open to all registered foals. The Racing Challenge receives funds from individuals for the nomination of their horses. Nominations received are used to supplement purse awards at Challenge races and are paid to the nominators and owners as bonus awards. Race entry fees are received from individuals to enter a Challenge race and are added to the purse award, along with the amount contributed by corporate sponsors. Investment income attributable to the Racing Challenge is included in the purse awards as well.

The following is a summary of activity of the Racing Challenge for the years ended September 30, 2013 and 2012:

|                                    | <u>2013</u>         | <u>2012</u>         |
|------------------------------------|---------------------|---------------------|
| Balance of fund, beginning of year | \$ 4,363,316        | \$ 4,325,714        |
| Program receipts                   | 2,906,300           | 2,389,834           |
| Investment income                  | 530,300             | 529,845             |
| Program disbursements              | <u>(3,279,613)</u>  | <u>(2,882,077)</u>  |
| Balance of fund, end of year       | <u>\$ 4,520,303</u> | <u>\$ 4,363,316</u> |

The investment balance allocated to the Racing Challenge as of September 30, 2013 and 2012 is included in the investment balance shown on the statements of financial position.

## AMERICAN QUARTER HORSE ASSOCIATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### Note 7 – Other Deferred Income

At September 30, 2013 and 2012, deferred income, not including deferred income related to the Incentive Fund and Racing Challenge programs, consisted of the following:

|  | <u>2013</u>          | <u>2012</u>          |
|--|----------------------|----------------------|
| Deferred breeder account   | \$ 3,615,573         | \$ 2,901,894         |
| Deferred membership income   | 8,422,760            | 9,354,029            |
| Deferred publications income   | 838,379              | 924,908              |
| Deferred world championship shows income (net of prepaid expense of \$570,543 and \$582,361) | 2,604,836            | 2,552,017            |
| Other deferred income  | <u>1,121,549</u>     | <u>2,756,537</u>     |
| Total other deferred income  | <u>\$ 16,603,097</u> | <u>\$ 18,489,385</u> |

#### Note 8 – Employee Benefit Plans

**Defined benefit plan** – The Association has a noncontributory defined benefit pension plan (the Plan) limited to participants who were in the Plan as of October 31, 2003, or active employees as of October 31, 2003 that subsequently become eligible by reaching 21 years of age and completing one year of eligible service. Benefits are based on years of service and the average of each participant's highest five years of compensation out of the last fifteen calendar years.

It is the Association's policy to fund the Plan consistent with the ERISA minimum funding requirements. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. Contributions are predominantly invested in equity securities.

The actuarial present value of benefit obligations is calculated based on certain assumptions pertaining to interest rates, inflation rates and employee compensation and demographics. Due to the uncertainties inherent in setting assumptions, it is reasonably possible that changes in these assumptions will occur in the near term and the effect of such changes could be material to the consolidated financial statements.

The Association follows FASB guidance surrounding employers' accounting for defined benefit pension and other postretirement plans, which requires companies that sponsor single-employer defined benefit plans to recognize the funded status of such plans in their statement of financial position. For pension plans, the funded status is measured as the difference between plan assets at fair value and the projected benefit obligation. Gains and losses and prior service costs that arise during the period, but are not recognized as components of net periodic benefit expense, are recognized as a separate line item or items within changes in unrestricted net assets.

**AMERICAN QUARTER HORSE ASSOCIATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 8 – Employee Benefit Plans (continued)**

**Obligations and funded status:**

|  | <u>2013</u>          | <u>2012</u>          |
|--|----------------------|----------------------|
| Cash and cash equivalents  | \$ 295,555           | \$ 188,180           |
| Plan assets at fair value  | <u>41,347,005</u>    | <u>36,762,816</u>    |
| Total plan assets at September 30  | <u>\$ 41,642,560</u> | <u>\$ 36,950,996</u> |
| Projected benefit obligation at September 30   | \$ (45,596,584)      | \$ (44,842,114)      |
| Funded status  | (3,954,024)          | (7,891,118)          |
| Accrued benefit cost recognized in the consolidated statements of financial position | (3,942,383)          | (7,891,118)          |
| Benefit cost   | 1,325,402            | 1,789,061            |
| Employer contributions   | 1,500,000            | 1,600,000            |
| Benefits paid  | 1,429,383            | 1,399,041            |

The projected accumulated benefit obligation for the defined benefit pension plan was approximately \$45,597,000 and \$41,882,000 at September 30, 2013 and 2012, respectively.

**Assumptions:**

|  | <u>2013</u> | <u>2012</u> |
|--|-------------|-------------|
| Weighted average assumptions used to determine benefit obligations at September 30:                    |             |             |
| Discount rate  | 4.75%       | 4.30%       |
| Rate of compensation increase  | 3.00%       | 1.50%       |
| Weighted average assumptions used to determine net periodic benefit cost for years ended September 30: |             |             |
| Discount rate  | 4.30%       | 5.35%       |
| Expected return of plan assets   | 7.00%       | 7.00%       |
| Rate of compensation increase  | 1.50%       | 3.00%       |

The Association's expected rate of return on plan assets is determined by the plan assets' historical long-term investment performance, current asset allocation and estimates of future long-term returns by asset class.

## AMERICAN QUARTER HORSE ASSOCIATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 8 – Employee Benefit Plans (continued)

Changes in plan assets and benefit obligations recognized in changes in unrestricted net assets are as follows:

|  | <u>2013</u>             | <u>2012</u>             |
|--|-------------------------|-------------------------|
| Interest cost  | \$ 1,889,461            | \$ 2,038,217            |
| Service cost   | 806,505                 | 816,525                 |
| Amortization of prior service credit   | (255,084)               | (255,084)               |
| Expected return on plan assets   | (2,589,425)             | (2,270,228)             |
| Net loss amortization  | <u>1,473,945</u>        | <u>1,459,631</u>        |
| <br>Total recognized in net periodic pension cost and<br>unrestricted net assets (recorded in general and<br>administrative expense) | <br><u>\$ 1,325,402</u> | <br><u>\$ 1,789,061</u> |
| <br>Actuarial loss recognized in net assets not yet included<br>in net periodic pension cost   | <br><u>\$ 3,942,383</u> | <br><u>\$ 7,891,118</u> |

**Plan assets** – The Association's pension plan weighted-average asset allocations at September 30, 2013 and 2012 by asset category are as follows:

|                | <u>2013</u> | <u>2012</u> |
|----------------|-------------|-------------|
| Asset category |             |             |
| Cash           | 1%          | 1%          |
| Mutual Funds   |             |             |
| Equity         | 41%         | 81%         |
| Balanced       | 6%          | 0%          |
| Bonds          | 25%         | 0%          |
| Real estate    | 9%          | 3%          |
| Common stock   | <u>18%</u>  | <u>15%</u>  |
|                | <u>100%</u> | <u>100%</u> |

The Association's investment policy for plan assets is to manage the portfolio to preserve principal and liquidity while maximizing the return on the investment portfolio through the full investment of available funds. The portfolio is diversified by investing in multiple types of investment-grade securities. The investment policy requires assets of the plan to be primarily invested in short-term securities with at least an investment grade rating to minimize interest rate and credit risk, as well as to provide for an immediate source of funds.

The Association attempts to mitigate investment risk by rebalancing between equity and bond asset classes periodically. Although changes in interest rates may affect the fair value of the investment portfolio and cause unrealized gains or losses, such gains or losses would not be realized unless the investments are sold.

**AMERICAN QUARTER HORSE ASSOCIATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 8 – Employee Benefit Plans (continued)**

**Cash flows** – The Association contributed more than the IRS minimum required contribution for the plan years ended September 30, 2013 and 2012 in the amount of \$1,500,000 and \$1,600,000, respectively. At this time, the Association anticipates contributing the IRS minimum required contribution for the 2014 fiscal year. This amount is not currently available, and the Association may provide additional funding for the plan.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

|             |                             |
|-------------|-----------------------------|
| 2014        | \$ 1,667,774                |
| 2015        | 1,830,318                   |
| 2016        | 1,940,929                   |
| 2017        | 2,095,896                   |
| 2018        | 2,214,698                   |
| 2019 - 2022 | <u>12,939,732</u>           |
|             | <u><u>\$ 22,689,347</u></u> |

Securities classified within Level 3 investments are based on valuations provided by the external investment managers. The Investment Committee, in conjunction with the external investment advisor, monitors and analyzes the valuation of the investments on a quarterly basis. The Investment Committee reports to the Board of Trustees. The valuations consider variables such as financial performance of investments, recent sales prices of investments, and other pertinent information.

Equity Mutual Funds, Balanced Mutual Funds, Bond Mutual Funds, International Common Stock – these classifications consist of investments in various funds and securities that have differing investment goals that are traded in an active market.

Real Estate Partnerships – this classification is invested in a portfolio of real property located in the United States. The General Partner of each partnership has the authority and discretion to manage and control the affairs of the Partnership, including selecting real property to invest in and when to sell owned assets. Investments held by the limited partnership generally are carried at fair value as determined by the respective general partners and may be based on various pricing models. The fair values of the investments in this category have been determined using the practical expedient methodology and are therefore valued at net assets value. The ability to liquidate these investments in the limited partnerships are restricted in accordance with the provisions of the partnership agreements, which state that invested capital is not returned until the dissolution of the partnerships.

## AMERICAN QUARTER HORSE ASSOCIATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### Note 8 – Employee Benefit Plans (continued)

Investments at September 30, 2013 are as follows:

|                          | Level 1              | Level 2     | Level 3             | Total                |
|--------------------------|----------------------|-------------|---------------------|----------------------|
| Common stocks            | \$ 7,259,468         | \$ -        | \$ -                | \$ 7,259,468         |
| Mutual Funds:            |                      |             |                     |                      |
| Equity                   | 16,700,934           | -           | -                   | 16,700,934           |
| Balanced                 | 2,174,044            | -           | -                   | 2,174,044            |
| Bonds                    | 10,078,547           | -           | -                   | 10,078,547           |
| International securities | 1,366,532            | -           | -                   | 1,366,532            |
| Real estate partnerships | -                    | -           | 3,767,480           | 3,767,480            |
|                          | <u>\$ 37,579,525</u> | <u>\$ -</u> | <u>\$ 3,767,480</u> | <u>\$ 41,347,005</u> |

Investments at September 30, 2012 are as follows:

|                          | Level 1              | Level 2     | Level 3             | Total                |
|--------------------------|----------------------|-------------|---------------------|----------------------|
| Common stocks            | \$ 5,389,387         | \$ -        | \$ -                | \$ 5,389,387         |
| Equity mutual funds      | 30,202,649           | -           | -                   | 30,202,649           |
| Real estate partnerships | -                    | -           | 1,170,780           | 1,170,780            |
|                          | <u>\$ 35,592,036</u> | <u>\$ -</u> | <u>\$ 1,170,780</u> | <u>\$ 36,762,816</u> |

The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows:

| 2013                                 | Real Estate<br>Partnerships |
|--------------------------------------|-----------------------------|
| Beginning balance at October 1, 2012 | \$ 1,170,780                |
| Total unrealized gain                | 104,886                     |
| Purchases                            | 2,491,814                   |
| Total                                | <u>\$ 3,767,480</u>         |
|                                      |                             |
| 2012                                 | Real Estate<br>Partnerships |
| Beginning balance at October 1, 2011 | \$ 1,282,475                |
| Total unrealized loss                | (111,695)                   |
| Total                                | <u>\$ 1,170,780</u>         |

## AMERICAN QUARTER HORSE ASSOCIATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 8 – Employee Benefit Plans (continued)

No changes in the investment valuation techniques occurred during the periods presented.

**Defined contribution plan** – The Association established a defined contribution 401(k) plan (the 401(k) Plan) during 1997. Employees are eligible to participate upon employment and reaching age 18. The 401(k) Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974. Under provisions of the 401(k) Plan, eligible employees are allowed to contribute up to 100% of their compensation each year, up to the maximum limits established by the Internal Revenue Service. The Association has the option to make contributions to the 401(k) Plan. The Association also provides for a 100% employer matching contribution to the 401(k) Plan as it relates to certain participants, up to a maximum matching contribution of 6% of participant deferrals. The participants covered under the matching provision are those employees not otherwise eligible for participation in the American Quarter Horse Association Employee Pension Plan (those employees hired subsequent to November 1, 2003). For the years ended September 30, 2013 and 2012, the Association contributed approximately \$238,000 and \$226,000, respectively, to the American Quarter Horse Association 401(k) Plan.

### Note 9 – Net Assets

Restricted purposes for temporarily and permanently restricted net assets at September 30, 2013 and 2012 are as follows:

|              | 2013                      |                           | 2012                      |                           |
|--------------|---------------------------|---------------------------|---------------------------|---------------------------|
|              | Temporarily<br>Restricted | Permanently<br>Restricted | Temporarily<br>Restricted | Permanently<br>Restricted |
| Operations   | \$ 168,114                | \$ 9,664,051              | \$ 113,282                | \$ 9,531,295              |
| Research     | 440,478                   | 5,203,624                 | 115,260                   | 4,665,814                 |
| Education    | 1,649,630                 | 1,878,390                 | 399,966                   | 1,836,989                 |
| Scholarships | 732,671                   | 5,908,933                 | 343,491                   | 5,247,797                 |
| Fundraising  | 82,033                    | -                         | 87,504                    | -                         |
|              | <u>\$ 3,072,926</u>       | <u>\$ 22,654,998</u>      | <u>\$ 1,059,503</u>       | <u>\$ 21,281,895</u>      |

### Note 10 – Endowment

**Endowment** – The AQHF endowment consists of several different individual funds established for a variety of purposes. AQHF's Board of Trustees does not have the ability to distribute any amount of the donor's initial permanently restricted contribution. In accordance with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the organization
- (7) The investment policies of the organization

## AMERICAN QUARTER HORSE ASSOCIATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 10 – Endowment (continued)

**Endowment investment and spending policies** – The Association has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment. The Association's investment and spending policies work together to achieve this objective. The investment policy establishes an achievable return objective through diversification of asset classes. The current long-term return objective is to compare to a similarly weighted benchmark representing the returns of the S&P 500 Index and the Intermediate Government/Corporate Index.

The Association targets a diversified asset allocation that places a greater emphasis on asset preservation while striving to achieve its long-term return objectives within prudent risk parameters.

The spending policy calculates the amount of money annually distributed from the earnings of the Association's various endowed funds. The current spending policy is to distribute an amount equal to 5% of the trailing thirty-six month average principal balance, limited to available undistributed earnings.

The changes in endowment net assets for the fiscal years ended September 30, 2013 and 2012 are summarized below:

|   | Unrestricted | Temporarily<br>Restricted | Permanently<br>Restricted |
|---|--------------|---------------------------|---------------------------|
| Endowment net assets at September 30, 2011                  | \$ (598,093) | \$ 214,332                | \$ 18,441,047             |
| Contributions   | -            | -                         | 2,990,848                 |
| Pledge receivable write-off                                 | -            | -                         | (150,000)                 |
| Investment return on endowment assets                       | 596,891      | 1,526,065                 | -                         |
| Net assets appropriated for expenditure                     | -            | (1,064,891)               | -                         |
| Endowment net assets at September 30, 2012                  | (1,202)      | 675,506                   | 21,281,895                |
| Contributions   | -            | -                         | 1,486,380                 |
| Pledge receivable write-off                                 | -            | -                         | (147,335)                 |
| Investment return on endowment assets                       | 1,202        | 2,342,191                 | 87,146                    |
| Net assets appropriated for expenditure                     | -            | (1,570,615)               | -                         |
| Net assets temporarily restricted due to donor requirements | -            | 53,088                    | (53,088)                  |
| Endowment net assets at September 30, 2013                  | <u>\$ -</u>  | <u>\$ 1,500,170</u>       | <u>\$ 22,654,998</u>      |

All Endowment net assets consist of donor-restricted endowment funds.

### Note 11 – Commitments and Contingencies

The Association is party to certain legal proceedings and other matters arising from time to time in the normal course of business. Management believes that such legal procedures will not have a material adverse effect on the Association's financial position or activities.

## AMERICAN QUARTER HORSE ASSOCIATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Note 11 – Commitments and Contingencies (continued)

On August 22, 2013, a judgment was entered against AQHA in the cloning lawsuit which involved anti-trust claims brought against AQHA for its decision not to register cloned horses or the offspring of clones. In the judgment, the Court assessed damages of \$31,581 (for court costs) and \$891,387 (for attorneys' fees) together with interest. In its verdict, the jury awarded no actual damages. Thus, the only money damages assessed in the judgment were for court costs and attorney fees. AQHA has appealed the judgment and is not obligated to pay the court costs and attorneys' fees until final ruling by the U.S. Fifth Circuit Court of Appeals. AQHA has antitrust insurance coverage through the D & O policy that covers the above court assessed damages.

### Note 12 – Note Payable

The Association initiated a single note in April 2013 which calls for monthly payments of \$10,798 including principal and interest. The note currently bears fixed interest rate of 3%. As of September 30, 2013, the balance outstanding on the note was \$562,867. Interest expense for the year ended September 30, 2013 was \$6,109.

Payments on this note are as follows:

|  |                          |
|--|--------------------------|
| Note payable                                   | \$ 562,867               |
| Current portion                                | <u>(114,035)</u>         |
| Long-term note payable, net of current portion | <u><u>\$ 448,832</u></u> |

Aggregate maturities on long-term debt at September 30, 2013 are as follows:

|      |                          |
|------|--------------------------|
| 2014 | \$ 114,035               |
| 2015 | 117,552                  |
| 2016 | 121,154                  |
| 2017 | 124,915                  |
| 2018 | <u>85,211</u>            |
|      | <u><u>\$ 562,867</u></u> |

### Note 13 – Subsequent Events

The Association has evaluated the impact of all subsequent events of the Association through January 30, 2014, the date the consolidated financial statements were available to be issued. No subsequent events were identified by management that required either recording or disclosure in the consolidated financial statements or notes for the year ended September 30, 2013.