

**UNIVERSITY OF KENTUCKY
BOARD OF TRUSTEES**

Minutes of meeting of the Audit Subcommittee of the Finance Committee

Tuesday, October 16, 2007

Subcommittee members in attendance: JoEtta Y. Wickliffe, Chair
Stephen Branscum

Board members in attendance: James. F. Hardymon

University staff: Lee T. Todd Jr., President
Frank Butler, Executive Vice President for
Finance and Administration
Angie Martin, Vice President for Planning,
Budget and Policy
Henry Clay Owen, Treasurer
Marc Mathews, Controller
Joseph Reed, Senior Director of
Internal Audit
Christine Donahoe, Assistant Controller
Shanhong Wang, Director General
Accounting
Gwen Conley, Manager General Accounting
Dan Adkins, Public Relations

Guests: Tom Mann, Deloitte
Kevin Joynt, Deloitte
Jessica Hamilton, Deloitte

Chair Wickliffe called the meeting to order at 10 a.m.

Since the external auditors were still engaged in a previous meeting, the agenda items were addressed in reverse order. Ms. Wickliffe called on Marc Mathews to discuss the Request for Proposal (RFP) for Annual Audit and Audit, Accounting and Tax Consulting Services (see Attachment A). Since this is the first time that the University has gone through the RFP process for external auditing services since the Audit Subcommittee was created, Mr. Mathews asked for guidance from the committee on how they would like to see the process work. It was decided that the University review committee, chaired by Frank Butler, would recommend the top firm(s) to the Audit Subcommittee. If there is one clear choice, that firm will be asked to do a presentation on January 22, 2008 to the Audit Subcommittee. If multiple firms are considered to be finalists, the presentations will be on a date prior to January 22 to be determined. Following the presentation(s) the Audit Subcommittee will select the firm to be awarded the contract.

Ms. Wickliffe next called on Joseph Reed, Senior Director of Internal Audit. Mr. Reed distributed the Internal Audit 2006 – 07 Annual Report (see Attachment B). He then reviewed the changes that had been made in Internal Audit's approach over the last few years and the metrics contained in the report. He next reviewed the work plan for FY2007-2008 (see Attachment C). A major change from prior years is that Internal Audit plans to dedicate approximately 550 hours to testing capital construction controls due to the growth in that area. Mr. Butler pointed out that some audits are required annually by statute, such as the Center for Rural Health, and some are done once at the department's request. An example of this is UK Athletic Association where at least one area is audited each year. Mr. Reed said that they also look at calls to the hot line when determining what areas to audit. Last year there were four calls concerning HIPAA compliance so this will be an area of focus in the future. The 2008 – 09 work plan will be presented at the spring Audit Subcommittee meeting.

The minutes of the April 24, 2007 meeting were then reviewed and approved (see Attachment D).

Ms. Wickliffe again recognized Mr. Mathews, who then introduced Tom Mann, Kevin Joynt and Jessica Hamilton from Deloitte and Chris Donahoe, Shan Wang and Gwen Conley from the University's accounting staff. Ms. Wickliffe thanked all of them for coming.

The Deloitte team distributed their report on Communications to the Audit Subcommittee and Management (see Attachment E). Mr. Mann reviewed the results of the fiscal 2007 audit, stating that the University received an unqualified opinion and had no material internal control weaknesses. He explained that Deloitte obtains a detailed understanding of each of the many business cycles and takes the nature of each cycle into consideration when designing internal control tests. He also reviewed the definitions of deficiencies and weaknesses that are required to be reported to the Audit Subcommittee. UK only had control deficiencies, the lowest level that has to be reported. No material weaknesses or significant deficiencies were identified.

Ms. Hamilton reviewed the accounting estimates and the critical accounting policies and practices regarding estimates. She also discussed the process whereby UK uses actuarial specialist to assist in determining some of the liabilities then Deloitte's specialists review and verify the results. She stated that managements is consistent in its method of calculating estimates and does not try to use them to manage earnings.

Required communications were then discussed by Mr. Joynt and Ms. Hamilton. Mr. Joynt noted that the report is more formal than in the past due to new auditing standards. It was noted that Deloitte found no exceptions to the acceptability and quality of accounting principles used by the University and that Deloitte received the full support of UK staff.

The passed adjustments were then reviewed. There was an overstatement of a capital lease and asset related to the purchase of Samaritan Hospital. This had no affect on the

income statement and will be corrected in fiscal year 2007 – 08. Deloitte believes that self-insurance reserves are overstated, on an aggregate basis, by approximately \$2.8 million. Recorded adjustments related to a \$5 million increase in the reserve for workman’s compensation and a \$3 million accrual for potential litigation liabilities. Mr. Owen mentioned that the University is over-accrued approximately \$10 million for medical malpractice liability and is generally very conservative in its approach to booking self-insurance liabilities.

Ms. Hamilton concluded the presentation by referring to the control deficiencies contained in the management comment letter dated October 5, 2007. (See Attachment F.) She stated that management has always been very responsive to Deloitte’s comments.

Ms. Wickliffe thanked Deloitte for a very thorough report.

Being no further business, the meeting adjourned at 10:50 a.m. The next meeting of the Audit Subcommittee will be held in January to hear presentations from firm(s) to perform the University’s external audit.