University of Kentucky
Pre-audit Report to the Audit Committee
March 10, 2009
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The purpose of this report is to summarize various matters relating to our approach for the June 30, 2009, audits of the financial statements of the University of Kentucky (UK) and its component units and affiliates.

**Audits of Financial Statements**

We will conduct our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. 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.

Our audits will be made for the purpose of rendering opinions on the following financial statements as of and for the year ending June 30, 2009:

- UK
- UK HealthCare Hospital System
- UK Research Foundation
- UK Athletic Association
- Kentucky Tobacco Research and Development Center
- The Fund for Advancement of Education and Research in the UK Medical Center
- Central Kentucky Management Services, Inc.
- UK Mining Engineering Foundation, Inc.
- UK Business Partnership Foundation, Inc.
- UK Gluck Equine Research Foundation, Inc.
We will audit the statements of financial position and the related statements of activities and cash flows for the year ending June 30, 2009, for the following:

- UK Humanities Foundation, Inc.
- UK Center on Aging Foundation, Inc.
- WUKY-FM Radio

We will audit the balance sheet and the related statements of operations, stockholder’s equity and cash flows for the period ended December 31, 2008, for the following:

- UK Alumni Association
- UK Faculty Club, Inc, d/b/a The Hillary J. Boone Center

An audit of the financial statements does not relieve management or the audit committee of their responsibilities.

Our audit approach emphasizes the areas of higher risk, focusing on the unique characteristics of the operating environment, the effectiveness of your internal control and your financial statement amounts and disclosures.

Based on our understanding of UK and our assessment of your internal control, we plan our audit to achieve the appropriate level of assurance regarding material misstatements and material weaknesses in internal control over financial reporting.

We have preliminarily identified the following areas as significant risks of material misstatement due to error or fraud and propose to address these areas as described:

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Planned Scope and Timing of the Audit

- UK Humanities Foundation, Inc.
- UK Center on Aging Foundation, Inc.
- WUKY-FM Radio

We will audit the statements of financial position and the related statements of activities and cash flows for the year ending June 30, 2009, for the following:

- UK Alumni Association
- UK Faculty Club, Inc, d/b/a The Hillary J. Boone Center

We will audit the balance sheet and the related statements of operations, stockholder’s equity and cash flows for the period ended December 31, 2008, for the following:

- Kentucky Technology, Inc. and subsidiaries
- Coldstream Laboratories, Inc.

An audit of the financial statements does not relieve management or the audit committee of their responsibilities.

Our audit approach emphasizes the areas of higher risk, focusing on the unique characteristics of the operating environment, the effectiveness of your internal control and your financial statement amounts and disclosures.

Based on our understanding of UK and our assessment of your internal control, we plan our audit to achieve the appropriate level of assurance regarding material misstatements and material weaknesses in internal control over financial reporting.

We have preliminarily identified the following areas as significant risks of material misstatement due to error or fraud and propose to address these areas as described:
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<th>Risk Area</th>
<th>Audit Approach</th>
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<td>Risk of management override of controls</td>
<td>Review accounting estimates for bias, review of journal entries, evaluate business rationale for unusual transactions</td>
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<td>Allowance for doubtful accounts and pledges receivable</td>
<td>Test management’s assertions with respect to the calculation of uncollectible accounts</td>
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<td>Contractual allowances and amounts due to/from third-party payers</td>
<td>Test management’s assumptions and estimates included in the contractual allowances and amounts related to cost reports</td>
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<tr>
<td>Self-insurance for medical malpractice, long-term disability, workers’ compensation and health insurance</td>
<td>Review management’s estimates for self-insurance and test completeness of liabilities</td>
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We welcome any input you may have regarding the risk areas identified above, any other significant risk areas in your opinion or other matters you believe warrant particular attention during the audit.

We may develop additional significant risks as we complete risk assessment procedures.

We propose the following timeline:

**Final Reports – October 1, 2009**

Final reports to the audit committee will be issued by the Commonwealth’s reporting deadline of October 1, 2009, which is prior to the October 27, 2009, scheduled meetings of the audit committee and the board of trustees.
✓ **Ongoing Communication**

Regular communication between the audit committee and the auditors is critical to the success of the audit. Accordingly, the audit team may be available to the board of trustees at any time throughout the audit, not just the prescribed times identified above. In addition, there may be instances which require communication during the audit (prior to delivery of the financial statements) such as:

- Fraud involving senior management
- Illegal acts
- Significant deficiencies and/or material weaknesses

We understand the appropriate person in the governance structure with whom to communicate is Mr. Stephen P. Bransum.

If for any reason, any member of the audit committee would need to contact us, please call Mary McKinley at 502.581.0435.

We wish to communicate the following significant matters related to the financial statement audit to you that are, in our judgment, relevant to your responsibilities in overseeing the financial reporting process:

✓ **Critical Accounting Policies and Practices**

- No matters are reportable

✓ **Alternative Treatments of GAAP**

- No matters are reportable

✓ **New Audit Techniques to be Applied**

- No matters are reportable
✓ **Critical Audit Areas**

- Contractual allowances, bad debts and amounts due to/from third-party payers
- Allowances for doubtful accounts and pledges
- Accounting for post-employment benefits
- Self-insurance liabilities
- Litigation reserves
- Evaluation of Ventas lease

✓ **Locations to be Visited and Scope of Audit Work at These Locations**

- UK, UK HealthCare and affiliates’ accounting departments
- Coldstream Laboratories, Inc.
- UK Alumni Association

✓ **Unusual Accounting Matters**

- No matters are reportable

✓ **New Accounting Pronouncements**

- Governmental Accounting Standards Board (GASB) 49 “Accounting for Financial Reporting for Pollution Remediation”
- GASB 52 “Land and Other Real Estate Held as Investments by Endowments”

✓ **Reliance on Internal Audit**

- We will review internal audit’s work plan and any related reports issued during the year ending June 30, 2009, to assist us in identifying risk areas and possibly to place reliance upon to reduce our detailed testing procedures. We will not utilize internal audit staff to provide direct staffing assistance to us during our auditing procedures.
Consideration of Errors or Fraud

One of the most common questions we receive from boards of trustees is, “How do you address fraud in a financial statement audit?” Our responsibility, as it relates to fraud, in an audit of financial statements is addressed in Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*.

Statements on Auditing Standards Nos. 104 - 111 address how we are to assess and respond to the risks of material misstatement due to error or fraud in an audit.

Our audit approach includes such procedures as:

✔ **Engagement Team Brainstorming**

- Discussions include how and where they believe UK’s financial statements might be susceptible to material misstatement due to errors or fraud, how management could perpetrate and conceal fraudulent financial reporting and how assets of the entity could be misappropriated.

- An emphasis is placed on the importance of maintaining the proper state of mind throughout the audit regarding the potential for material misstatement due to errors or fraud.

✔ **Inquiries of Management and Others**

- Personnel interviewed include the audit committee chair, president, treasurer, provost, controller and others.

- Inquiries are directed towards the risks of errors or fraud and whether personnel have knowledge of any fraud or suspected fraud affecting UK.
At this time, we would certainly welcome any questions that the board of trustees may have. As always, you may also contact Mary McKinley at 502.581.0435 at any time.

Our clients deserve and, to the best of our ability, receive unmatched client service. We welcome the opportunity for you to experience the same as we deliver the services outlined above.

Our goal is to deliver results with integrity: results that are unquestionably ethical while also practical, timely and affordable.