Chair Branscum called the meeting to order at 9:05 a.m. and welcomed everyone.

The minutes of the September 15, 2009 were reviewed and approved.
Chair Branscum then introduced Mary McKinley, partner from BKD, UK’s external auditor, and Chris Graff, BKD audit manager. Ms. McKinley indicated that the audit went well with all deadlines met and excellent cooperation from the University staff. Mr. Graff, who supervised the audit, then reviewed the three reports submitted by BKD.

1. The Independent Accountants’ Report on University of Kentucky Financial Statements for the year ended June 30, 2009
2. The Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements

Mr. Graff called attention to page 1 of the report where it is indicated that the University received an unqualified opinion. There were no major changes this year other than a change in accounting guidance that required the University to change the classification of Pell grant revenue from operating to nonoperating. The University also received a clean opinion on the Report on Internal Controls. There were a few findings related to the audit of Student Financial Aid; however they were not material to the audit.

Mr. Graff then discussed the Management Letter. Ms. Curris asked why Kentucky Medical Services Foundation (KMSF) was not among the entities audited by BKD listed on the first page. It was explained that KMSF is not an affiliate of the University but a nonaffiliated related entity and thus not subject to the same regulations as the University.

While discussing the use of estimates, Mr. Graff pointed out that alternative investments are difficult to value and can be a significant source of risk. As the University increases this type of investment, the risk will also increase. The financial statement disclosure on economic conditions has been added this year due to uncertainties brought about by the current circumstances. When asked if BKD used measurement such as those required by Sarbanes-Oxley, Ms. McKinley stated that they use something similar when testing internal controls.

The University had no material weaknesses or significant deficiencies. However one other control deficiency was noted. BKD proposed passed adjustments consisting primarily of unrecorded liabilities and related accounts receivable and a deferred loss on bond defeasance. This issue was also noted in the prior year. Chair Branscum mentioned that he had a conference call with BKD and management regarding the audit. Management continues to try to improve in this area through communication and by teaching classes to the campus. Ms. Beck discussed the types of adjustments, primarily subcontracts on grants and employee reimbursements. Mr. Graff stated that the passed adjustments related to several entities but was immaterial to any of them. Mr. Miles asked for the exact amount of the materiality level used by BKD. Ms. McKinley said the firm does not disclose that information and that it’s different for each of the entities.

After Mr. Graff finished the review of the reports, Chair Branscum asked if the University intended to continue offering the year end classes. Ms. Beck responded that
they would be offered in the future and that management hoped to reach a different audience.

Ms. McKinley mentioned in closing that BKD enjoyed the engagement and is glad to have UK as a client. Chair Branscum asked about the timing of the December 31 audits of the for-profit companies. Planning meeting with both of them are scheduled for after the board meeting with fieldwork to take place in April and the audit reports issued prior to June 30.

Mr. Dawson moved to accept the BKD reports with Mr. Miles seconding. The motion carried.

Chair Branscum called on to Joseph Reed to present the Internal Audit reports. First was a summary of the comply-line activity for the year. After elimination of duplicate complaints and general questions, there were 30 to 36 calls with little of substance reported. This is about the same as the previous year.

Mr. Reed then discussed highlights of the Quality Assessment Review of Internal Audit that was recently completed by the Institute of Internal Auditors. The review was very beneficial with many positive comments including added value provided by IA, a high level of confidence in IA and strong top-level support. There were also suggestions for improvement such as updating the activity charter more frequently, strengthening the work papers by improving skill sets of staff and utilizing more computer assisted audit techniques. IA is trying to do more with the same amount of resources so must prioritize recommendations. Several of them will be difficult to carry out without additional staff.

Highlights of the IA annual report were then reviewed. Mr. Reed commented on how beneficial it has been to have interns on staff, both for the department and the student. Dr. Brockman commented on the audit completion rate of 50% and asked how many people it would take to increase that rate. Mr. Butler explained how things such as the College of Pharmacy Continuing Education investigative audit, which arose from a core review, can impact the ability to complete planned audits. Certain areas such as athletics and Hazard Rural Health Center are done every year due to risk factors and/or legal requirements. When asked about turnover, Mr. Reed stated that they don’t have much turnover but agreed that it does create a problem when it occurs. IA has six auditors and has only lost three in the last five years.

Chair Branscum stated that the internal audit program has come a long way under Mr. Reed and applauded the QAR rating. Dr. Todd also noted the big improvement since he came into office.

Mr. Gatton asked if BKD and IA audited investments. Ms. McKinley described the evaluation process used by BKD, particularly in regard to alternative investments such as hedge funds. BKD would bring it to the attention of management if investment managers were deemed to have lack of internal control but does not audit investment results as those are management’s responsibility. Internal Audit does not audit investments.
Dr. Brockman moved to accept the Internal Audit reports with Mr. Miles seconding. The motion was approved.

The last item on the agenda was approval of the audit engagement letter for the fiscal year ending June 30, 2010. Ms. Beck explained that it was necessary to bring it to this meeting instead of the spring as was done in the past because the December 31 audits are about to get underway.

Mr. Dawson and Dr Brockman moved to approve the letter and the motion carried.

The next meeting of the Audit Subcommittee will be March 9, 2010 at which time BKD will bring pre-audit communications for the June 30, 2010 audit to the subcommittee and Mr. Reed will provide the 2010-2011 work plan and an activity update.

Being no further business, the meeting adjourned at 10:00 a.m.

Respectfully submitted,

[Signature]

Christine Donahoe