Approval of Minutes
The minutes of the January 29, 2013 Audit Subcommittee meeting were approved as presented.

Reports and Discussion Items

I.  BKD Discussion regarding audit of financial statements for year ending June 30, 2013
Ms. Mary McKinley, BKD Partner introduced Ms. Joanie Duckworth, the BKD Supervisor on the audit. Ms. McKinley then reviewed the attached Pre-Audit Report to the Audit Subcommittee (Attachment B). This standard report outlines the FY 2013 audit plan and the corresponding audits of the University of Kentucky and its subsidiaries. The scope is similar to prior years with the exception of the audit of the UK Department of Intercollegiate Athletics. It will have a broader scope and include more accounts and balances than that of the former University of Kentucky Athletic Association. Ms. McKinley noted that the final audit report is not due to the State until October 4. However, BKD will issue the report prior to October 1, well in advance of the October Audit Subcommittee (ASC) meeting.

Ms. McKinley mentioned several new relevant accounting pronouncements. Governmental Accounting Standards Board (GASB) No. 63 will change the format of financial statements. She noted that GASB No. 65 is forthcoming and will impact UK as it redefines what are assets and liabilities. For example, UK bond issuance costs can currently be capitalized or expensed; going forward bond issuance costs must be expensed. Ms. McKinley also mentioned the new Statement on Auditing Standards (SAS) No. 122 requiring BKD to obtain letters from external legal counsel retained by UK in addition to the letter from the UK Office of Legal Counsel.

II.  Update on Audit Subcommittee Charter revision
Mr. Eric Monday, Executive Vice President for Finance and Administration, explained that a group from Internal Audit, the Treasurer’s Office, EVPFA and General Counsel met and compiled best practice and audit committee charter benchmark information. They discussed UK’s current Audit Subcommittee Charter and its history, and the audit committee charter template as recommended by the Institute of Internal Auditors (IIA). This group will circulate a revision in the next few weeks for review. General Counsel, Mr. Bill Thro noted that because the charter is part of the AR and GR structure, it will require a first and second reading. Mr. Monday noted that the revision will be ready for the first reading at the next ASC meeting.

III.  FY 2012-13 Internal Audit activity update
Mr. Joe Reed, Senior Director Internal Audit, introduced the Internal Audit leadership team and the newest business auditor who will start on April 1. He also reported the status of hiring a new IT auditor. Discussion regarding the necessity of hiring another IT auditor was explained in
terms of the IT auditing workload. Also explained was a higher educational model for Internal Audit staffing that usually has a business audit and an IT audit side. With the new IT auditor, Internal Audit will have 2 ½ IT auditors (one staff is ½ business and ½ IT).

Mr. Reed reviewed the attached presentation illustrating the status of the FY 2013 Internal Audit activity as of February 17, 2013 (Attachment C). Beginning with the FY 2013 UKIA Approved Work Plan, Mr. Reed noted that the cash audits have been engaged since the last meeting. He noted that there is no management response due to the quick turnaround of the cash audit reports. Chair Britton mentioned that there were a few deficiencies noted in the cash audit reports and asked how they are handled. Mr. Reed noted that the executives in charge are made aware to ensure that proper attention is given. Chair Britton asked if the Audit Subcommittee would be receiving reports related to the cash audit follow-up activity. Mr. Reed explained that at the end of the year, there will be a Compliance Report that will include all follow-up results of the cash audits. The Athletics Assessment is complete and the review of Athletics’ Ticket Office is currently underway. President Eli Capilouto asked Mr. Reed if there were any external reviews done of UK Athletics as part of our overall participation in Conference activities (e.g. Academics audits). Mr. Reed confirmed that the SEC does conduct periodic audits of UK Athletics.

Hours of audit coverage by enterprise division continue to be spent on the academic area due to the College of Engineering and College of Fine Arts reviews. The increase in audit hours spent on UK HealthCare was due to the cash audits.

Productivity is at 84% (metric is 75%). The metrics for recommendations accepted, survey results and audit duration are currently being achieved. Mr. Reed noted that he anticipates that the work plan completion rate by the fiscal year end will be around 70% with most remaining activity engaged. Mr. Stuckert asked Mr. Reed about work plan completion and the ratio of planned work to unplanned activity; were the cash audits planned? Mr. Reed noted that the cash audits were on the FY2013 audit work plan. He mentioned that in developing the FY2013 audit work plan, he used the 90-10 rule for planned versus unplanned activity as he wanted to provide more audit coverage; the 80-20 rule would have been more accurate.

There being no further business, the meeting was adjourned.

Next Meeting
Tuesday, May 14, 2013
- Internal Audit FY 2012-13 activity update
- Internal Audit FY 2013-14 work plan process
- Audit Subcommittee Charter revision (1st reading)

Respectfully submitted,

Catherine Miller
University of Kentucky

Pre-Audit Report to the Audit Subcommittee

March 19, 2013

BKD LLP
CPAs & Advisors
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The purpose of this report is to summarize various matters relating to our approach for the June 30, 2013 audit of the financial statements of the University of Kentucky (UK) and its subsidiaries.

Audits of Financial Statements

We will conduct our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in Government Audit 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. These standards require we plan and perform the audit 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, 2013:

- UK
- UK Healthcare Hospital System (Hospital)
- UK Department of Intercollegiate Athletics
- WUKY – FM Radio

Our engagement also includes audits of the financial statements of the following entities, which are discussed in separate pre-audit reports to the governance of those respective entities:

- UK Research Foundation
- The Fund for Advancement of Education and Research in the UK Medical Center
- Central Kentucky Management Services, Inc.
- UK Mining Engineering Foundation, Inc.
An audit of the financial statements does not relieve management or the audit subcommittee of their responsibilities.

**Other Services**

Other services we will provide include:

- Audit of the Schedule of Expenditures of Federal Awards
- Preparation of annual bond arbitrage calculations
- Agreed-upon procedures in accordance with the NCAA’s Financial Audit Guidelines
- Attestation report on the Annual Financial Report to the Corporation for Public Broadcasting for WUKY-FM Radio

The actual terms of our engagement are more fully documented in an engagement letter dated January 15, 2013, and signed by you and BKD.

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 your entity 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>Audit Approach</th>
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<td>UK and Affiliates</td>
<td>Review accounting estimates for bias, review of journal entries, evaluate business rationale for unusual transactions</td>
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<td>Risk of management override of controls</td>
<td>Review management’s estimates for self-insurance and test completeness of liabilities</td>
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<td>Self-insurance for medical malpractice, long-term disability, workers’ compensation, health insurance and litigation reserves</td>
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<td>Valuation of alternative investments</td>
<td>Confirm investment balances and test selected investments accounts</td>
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<td>Allowance for doubtful accounts and pledges receivable</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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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 audits.

We may identify additional significant risks as we complete risk assessment procedures.
We propose the following timeline:

- **Final Reports – October 1, 2013**

  Final reports to the audit subcommittee will be issued prior to the Commonwealth of Kentucky’s reporting deadline of October 1, 2013, which is prior to the October 12-13, 2013, scheduled meetings of the audit subcommittee and board of trustees.

- **Ongoing Communication**

  Regular communication between the audit subcommittee 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
  - Material instances of noncompliance for federal award programs

  We understand the appropriate person in the governance structure with whom to communicate is Mr. Bill Britton.

  If, for any reason, any member of the audit subcommittee would need to contact us, please call Mary McKinley at 502.581.0435.
Auditing and Accounting Matters

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 Generally Accepted Accounting Principles (GAAP)
  • No matters are reportable.

✓ New Audit Techniques to be Applied
  • No matters are reportable.

✓ Critical Audit Areas
  • See risk areas discussed above.

✓ Locations to be Visited and Scope of Audit Work at These Locations
  • UK, UK Hospital and affiliates’ accounting departments.

✓ Unusual Accounting Matters
  • No matters are reportable.

✓ New Accounting Pronouncements
  • Governmental Accounting Standards Board (GASB) No. 61 *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*
  • GASB No. 63 *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*
Reliance on Internal Audit

- We will review internal audit’s work plan and all internal audit reports issued during the year ending June 30, 2013, to assist us in identifying risk areas, and to possibly place reliance upon internal audit’s work 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 auditing standards generally accepted in the United States of America.

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 UK 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 subcommittee 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
Questions, Observations or Suggestions From the Subcommittee

- Reviewing Accounting Estimates for Bias
- Evaluating Business Rationale for Significant Unusual Transactions
- Incorporating an Element of Unpredictability Into the Audit Each Year

At this time, we would certainly welcome any additional 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.
## FY 2013 UKIA Approved Work Plan

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## FY 2013 UKIA Unplanned Reviews

| 1 Art Sculpture Department Donations | 1  |
| 2 Lockbox Inventory | 2  |
| 3 Consultation - Fleet Inventory Management Process | 3  |
| 4 Consultation - Account Reconciliation Process | 4  |
| 5 Consultation - Account Reconciliation - Record Retention | 5  |
| 6 Consultation - Independent Contractor Form Requirements | 6  |
| 7 Consultation - College of Ag Extension Offices - IT | 7  |
| 8 Consultation - Gift Restriction Compliance | 8  |
| 9 Consultation - Tracking of Minor Assets | 9  |
| 10 Consultation - Telephone Records - Record Retention | 10 |
| 11 Consultation - Administrative Manual Development | 11 |
| 12 Real Estate Services | 12 |

## FY 2013 UKIA Audit Coverage By Enterprise Division

### Academic Coverage
- Number of Reviews, Committees, Consultations: 8
- Project Hours: 4,791

### UK Health Care
- Number of Reviews, Committees, Consultations: 13
- Project Hours: 1,296

### Finance and Administration
- Number of Reviews, Committees, Consultations: 11
- Project Hours: 469

### Campus
- Number of Reviews, Committees, Consultations: 2
- Project Hours: 28

### UK Administration (Includes Athletics)
- Number of Reviews, Committees: 3
- Project Hours: 730

### Affiliates
- Number of Reviews, Committees: 0
- Project Hours: 0

## FY 2013 UKIA Metric Update

### Productivity
- Goal @ 75%
- Performance @ 84% (7,663 Direct Hours; 9,005 Total Hours)

### Infrastructure
- Hours vs. Direct Hours - Goal @ 15% of Direct Hours
- Performance @ 5% (349 Infrastructure Hrs; 7,663 Direct Hrs)

### Recommendations Accepted (Requiring Management Response)
- Goal @ 75%
- Performance @ 100% (15 accepted; 15 total)

### Survey Results
- Goal @ 3.0 (average scale 1 is not satisfied and 4 is very satisfied)
- Performance @ 3.4 average (based on 6 surveys received)

### Audit Duration
- Goal @ 6 - 12 weeks
- Performance @ 7 weeks (3 Audits - 50 Days Average)

### Work Plan Completion Rate
- Goal @ 100%
- Performance @ 27% (15 Planned; 4 Completed)